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Report of the
Auditor General
of Canada
to the House of Commons

Chapter 28
Agriculture and Agri-Food Canada –
The Western Grain Transition Payments Program

November 1996



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Chapter 28
**Agriculture and Agri-Food Canada –
The Western Grain Transition Payments Program**



November 1996

This November 1996 Report comprises 19 chapters, including "Matters of Special Importance", as well as a Foreword and the Main Points from the May, September and November 1996 Report chapters. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.

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Chapter 28

Agriculture and Agri-Food Canada

The Western Grain Transition Payments Program

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants.

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Assistant Auditor General: Don Young
Responsible Auditor: Doug Timmins

Agriculture and Agri-Food Canada

The Western Grain Transition Payments Program

Main Points

28.1 The Western Grain Transition Payments Program (the Program) provides \$1.6 billion to Prairie landowners to compensate for the anticipated decline in land values attributable to the termination of the “Crow Benefit” transportation subsidy, effective 1 August 1995. The Program’s design and administration are the responsibility of Agriculture and Agri-Food Canada.

28.2 The decision to end the long-standing subsidy was one component of a significant change in government policy, aimed at reforming the Western grain transportation system. The decision will contribute to fiscal restraint in the longer term by ending the annual “Crow Benefit” of \$560 million.

28.3 The Department was cognizant of problems in the delivery of the Northern Cod Adjustment and Recovery Program (NCARP), which this Office had reported in 1993, and took appropriate steps to avoid repeating them.

28.4 Within 16 months, the Department gathered and processed sufficient data to enable 209,887 landowners to receive an interim payment equal to approximately 71 percent of the total entitlement from the Program. In total, eligible landowners will receive payments of between \$7.25 and \$48.31 per acre, depending on the distance to port and the productivity of their land.

28.5 We found that the payments were calculated pursuant to the Program’s enabling Act and regulations. We also found that the Department made substantial efforts to ensure that the payments were made on a timely basis, given constraints on data availability. In addition, we performed a limited review of the key internal controls governing the payment process. Nothing came to our attention in the course of this review to suggest that there were significant problems with these payments.

28.6 The Department needs to monitor and assess over the long term the direction of changes related to the goal of crop diversification and development of value-added processing industries.

Introduction

Historical background

28.7 From 1897 through 1983, Prairie farmers paid fixed rates for transportation of the majority of Western grain production. In the early 1960s it became clear that the railways were losing money in handling grain traffic, and consequently the federal government introduced various programs to try to maintain and improve the Western grain transportation and handling system. These efforts culminated in the introduction of the *Western Grain Transportation Act (WGTA)*, which was implemented in 1984.

28.8 One of the Act's main provisions committed the federal government to sharing in the costs of rail transportation of Western grain destined for specified Canadian ports (primarily Thunder Bay and Vancouver). The government's commitment (the *WGTA* subsidy, often referred to as the "Crow Benefit" after the Crow's Nest Pass Agreement of 1897) was paid directly to the railroads on behalf of producers. The subsidy was initially set at \$658.6 million in 1984, but the government's commitment provided that the amount could vary depending on the results of quadrennial costing reviews and the impact of inflation.

28.9 Fiscal pressures and the results of the 1992 costing review resulted in reductions in the *WGTA* subsidy, from \$726 million in 1992–93 to \$560.6 million in 1994–95; further reductions appeared likely. In addition, the Uruguay Round of the General Agreement on Tariffs and Trade (GATT) concluded with announcements that export subsidies (as a portion of the *WGTA* subsidy was considered to be) would face substantial reductions over the next few years. Further, bottlenecks developed in

transporting grain to Canada's export markets, prompting complaints from customers and raising questions about Canada's ability to get the product to market when customers needed it. As part of their pre-1995 Budget consultations, the ministers of Agriculture and Agri-Food and Transport asked for the views of industry and farmers on reforming the Western grain transportation and handling system, including changes to the *WGTA* subsidy.

Overview of Western grain transportation reform

28.10 The 1995 Budget terminated all federal railway transportation subsidies because the government felt that the Western grain transportation and handling system was slower, costlier and less efficient than was needed by farmers to be fully competitive in world markets. Exhibit 28.1 provides a visual overview of the Western grain transportation reform. The government hoped to achieve four main goals:

- to contribute to fiscal restraint;
- to comply with new international trading obligations regarding export subsidies;
- to encourage the evolution of a more efficient and effective transportation system for moving Western grains to market; and
- to encourage crop diversification and the development of more "value-added" processing of agricultural products.

28.11 The government believed that it would need to make three major changes to achieve these goals:

- end the subsidy referred to as the Crow Benefit;
- allow the sale or abandonment of unprofitable, grain-dependent railway lines; and

- revamp the Canadian Wheat Board pooling system (the way producers share transportation costs).

28.12 The government recognized that ending the subsidy would have negative financial implications for certain segments of the Western economy. Accordingly, some form of financial assistance would be required to help the affected areas adapt. The Western Grain Transition Payments Program, the subject of our audit, provided \$1.6 billion to compensate


landowners for the loss of the subsidy, while the Western Grain Transportation Adjustment Fund provided \$300 million to help industry adapt to the changes. Both of these programs are components of the government’s Western grain transportation reform initiative.

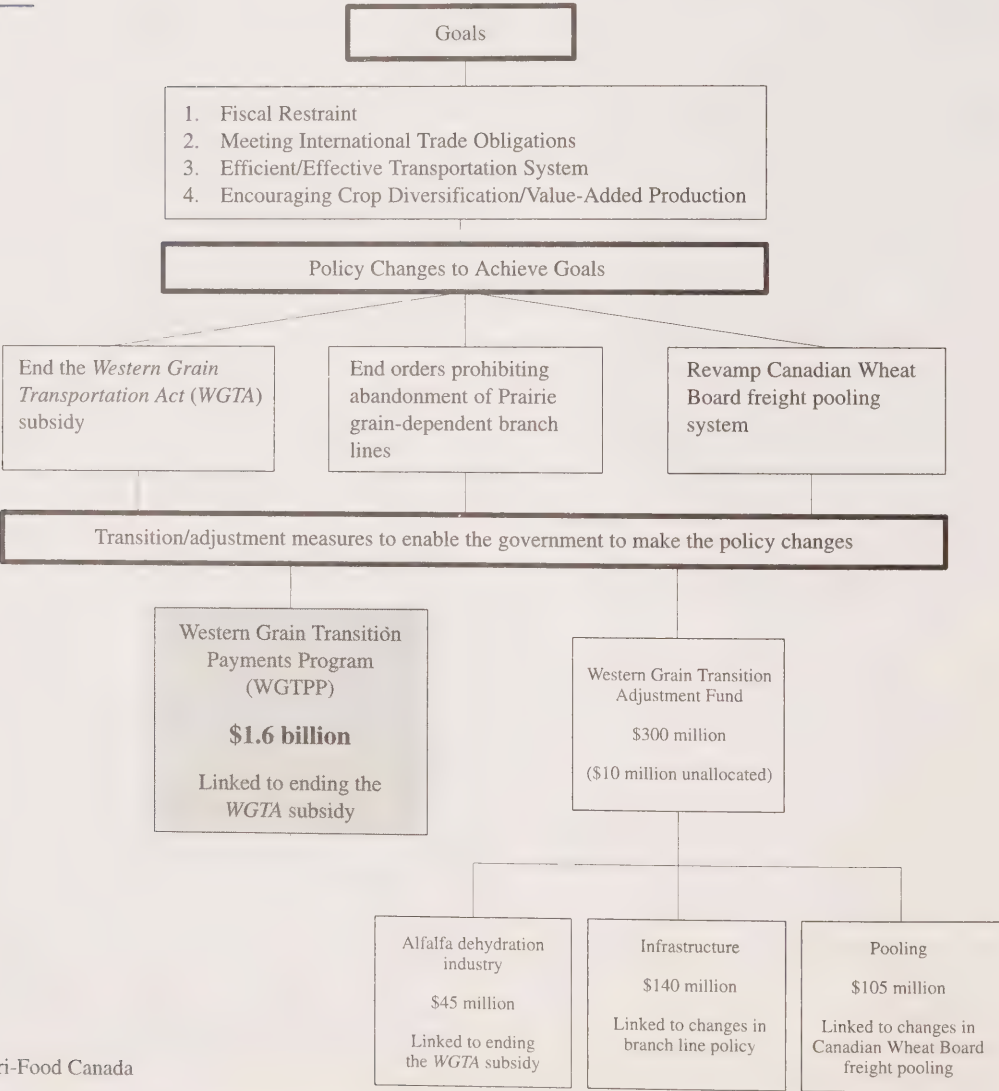
Description of the Western Grain Transition Payments Program

28.13 The stated intent of the Western Grain Transition Payments Program is to compensate landowners for loss in the

Exhibit 28.1

Western Grain Transportation Reform

 Program audited



Source: Agriculture and Agri-Food Canada

value of their property attributable to the elimination of the Crow Benefit. This transition program distributes \$1.6 billion to landowners in Alberta, Saskatchewan, Manitoba and certain areas of British Columbia, as shown in Exhibit 28.2. Landowners are eligible to be paid under the Program provided that a crop eligible for the *WGTA* subsidy was grown in the 1994 crop year or, where the land was summer-fallowed in 1994, an eligible product had been grown in the 1993 crop year. The total compensation was allocated to three regions on the basis of the nine-year average payments from the *WGTA* subsidy (1985–86 to 1993–94 inclusive), as shown in Exhibit 28.3.

28.14 The \$1.6 billion was to be paid out in two instalments: an interim payment of approximately 75 percent

(which had been paid by the time our audit work concluded in August 1996), with a final payment of the remainder scheduled for the fall of 1996. The amount of payment is based on a formula that considers the number of eligible acres; the productivity of the soil; whether or not the land is irrigated; and the distance of the land from the nearest port (the closer of Vancouver or Thunder Bay). Based on data from the first interim payments, the average payment to a landowner will be approximately \$7,624 in total.

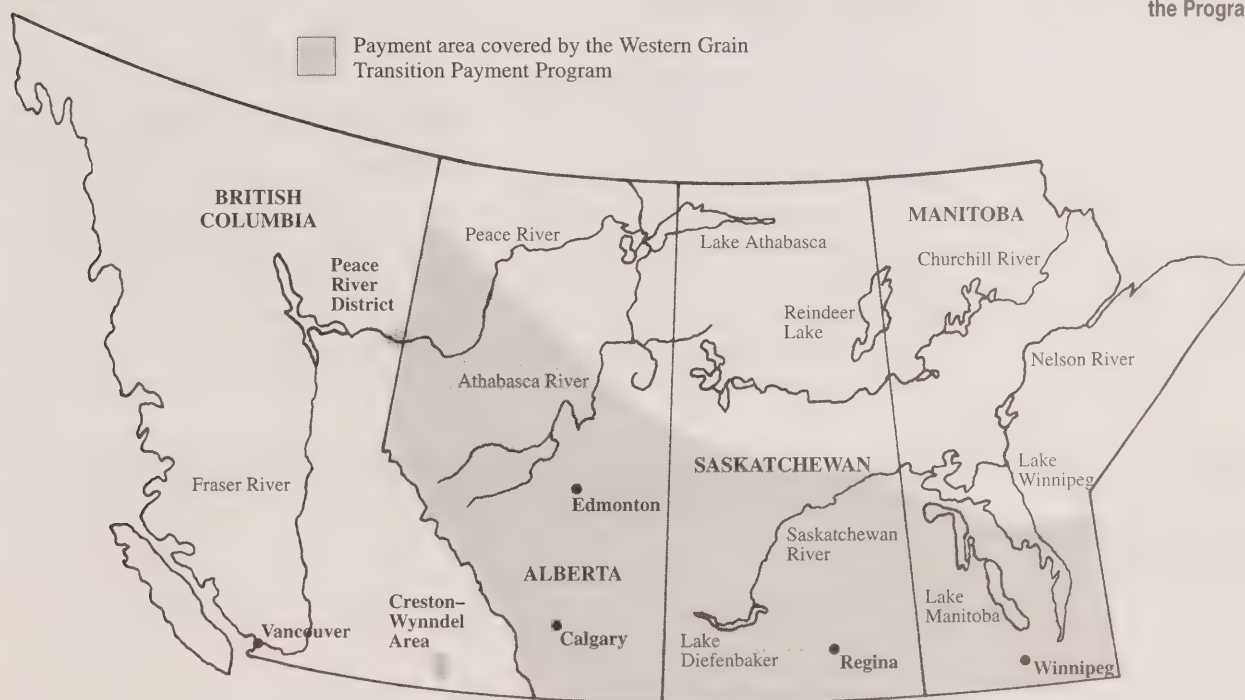
Focus of our audit

28.15 We conducted this audit with a view to assessing the adequacy of the Program's design to implement the Budget decision; the Department's monitoring of potential impacts; the calculation of payment factors; and the verification of

This transition program distributes \$1.6 billion to landowners in Alberta, Saskatchewan, Manitoba and certain areas of British Columbia.

Exhibit 28.2

Payment Area Covered by
the Program



Source: Agriculture and Agri-Food Canada

applications and calculation of interim payments.

28.16 Since the Program is also an integral component of the government's efforts to reform the Western grain transportation system, our audit work was extended to examine relevant aspects of the broader objectives of this reform initiative. It should be noted that both Agriculture and Agri-Food Canada and Transport Canada have significant roles in these reform efforts. Our audit addressed only Agriculture and Agri-Food Canada and its responsibilities related to those objectives. Further details are presented in **About the Audit**, at the end of the chapter. The government's administration of the *WGTA* Program and certain matters related to the proposed reform were the subject of an earlier Report by this Office in May 1995.

Observations and Recommendations

Learning from a Similar One-Time Federal Payout Program

28.17 Although each one-time payout program has unique characteristics, we expected that this new payout Program would apply lessons from past programs. In addition, we expected that the Department would evaluate the Program to identify lessons for the future.

28.18 In our 1993 Report on the Northern Cod Adjustment and Recovery Program (NCARP), we reported on a number of issues involving payments to individuals affected by the government's moratorium on the Northern cod fishery. As we expected, the Department had considered those issues when developing the control framework for this Program. Exhibit 28.4 summarizes some of our observations on NCARP and the extent to which they were addressed in this Program.

28.19 The Department also took other steps at an early stage to ensure that Program controls were adequate, so that any weaknesses detected could be addressed before interim payments were made.

28.20 An evaluation of this Program would be beneficial in identifying best practices and lessons for future programs. The Department is considering an evaluation of the Program, and has ranked it as a moderate priority in its 1996-97 "Review Plan".

Implementing the Budget Decision

28.21 The Budget decision specified that a one-time payment would be made to landowners to compensate for the decline in land values anticipated as a result of ending the subsidy. We expected that the Department would consider design

Exhibit 28.3

Allocation of Program Funds to Regions

Source: Agriculture and Agri-Food Canada

Region	% Allocated	\$ Allocated
Manitoba	16.10	257,600,000
Saskatchewan	56.42	902,720,000
Alberta, as well as those parts of British Columbia known as the Peace River District and the Creston-Wynndel areas	27.48	439,680,000
Total	100.00	1,600,000,000

alternatives to implement the Budget decision.

28.22 In this regard, the Department had available a recent study completed in June 1994 by the “Producer Payment Panel”. The Panel had been created in 1993 by the Minister of Agriculture and Agri-Food and given a mandate to develop a mechanism for paying the WGTA subsidy to producers rather than to the railways.

28.23 This Panel included experts and technical working groups, and consulted extensively with interested parties. The Panel and its working groups considered the results of the numerous studies conducted since the late 1970s; it carried out its own analyses and incorporated the relevant considerations arising from more recent events such as the GATT. The Department relied extensively on the Panel’s findings and recommendations to determine how to distribute the compensation.

28.24 The Panel recommended that compensation for the loss of the Crow Benefit be assigned to parcels of land and that it take into account the two factors related to the subsidy, namely:

- the farther the land was from port, the greater the impact on freight costs per tonne; and
- the more the land produced, the greater the impact on total freight costs.

28.25 Consistent with this recommendation, the Department distributed the compensation to landowners taking into account productivity and distance.

28.26 Paying each landowner the same amount of compensation per acre would have been expeditious but would not have reflected the real impact on land values. By the same token, it would not have been practical to consider the particular impact on each of 210,000 landowners for 730,000 parcels of land and to negotiate an amount of compensation that considered unique circumstances fully, particularly since actual reductions in land values would be difficult to determine and would occur only over time, through natural market forces.

28.27 Further to the Program legislation, the Department developed two payment factors — distance and productivity — to allow it to calculate the amount of compensation per acre that a landowner would receive. A third factor — irrigation — was later developed. These payment factors were used to adjust payments to take into account the expectation that removing the subsidy would impact land values in different ways. Payment factors are significant, since their application results in a range of estimated transition payments, varying from \$7.25 to \$48.31 per acre.

**Payments vary from
\$7.25 to \$48.31 per
acre.**

NCARP Observation	Western Grain Transition Payments Program
Lack of clear legislative authority for the program	The <i>Western Grain Transition Payments Act</i> and its regulations provide clear authority.
Difficulty in targeting the intended recipients	Parliament made deliberate decisions on whom to target. For example, payments are to landowners, and forage is excluded.
Payments made to individuals who did not meet eligibility criteria	We found no evidence of this based on our review of interim payments.

Exhibit 28.4

**NCARP Observations and
Transition Program**

The Department concluded that it would not be practical to measure or monitor the specific impact on land values of ending the subsidy.

Monitoring Impacts

Measuring the impact of the Program was not considered practical

28.28 Treasury Board requires that departments conduct evaluations of key policies and programs to determine, among other things, whether they are effective in meeting their objectives. Given that the intent of this Program was to compensate “owners of Prairie farm land in recognition of the impact on land values that may result from the termination of the long-standing (subsidized) freight rates”, we expected that the specific impact on land values would be assessed. However, the removal of the subsidy is only one among many factors, such as grain prices, that influence land value. The influence of these other factors can be variable and highly significant. The Department concluded that it would not be practical to measure or monitor the specific impact on land values of ending the subsidy. Although the specific impact on land values may not be easily determinable, it and other impacts, intended or unintended, need to be evaluated.

Assessing progress against the broad goals of reform

28.29 Since assessing the achievement of the Program objective — compensation for the impact on land values — was not considered practical by the Department, we looked at the extent to which it was measuring and monitoring the broader impacts of the removal of the subsidy. The government had established four broad goals for transportation reform (see Exhibit 28.5). The Department considers that the intended impacts in all four areas have been achieved, in that this compensation program has permitted the transition to the new transportation system while also contributing to fiscal restraint,

complying with international trading obligations and removing impediments to crop diversification.

28.30 Previous studies that looked at terminating the subsidy had predicted that it would result in crop diversification and livestock production as well as the development of value-added processing industries. Therefore, the fourth goal has more ongoing significance to the Department. We expected that the Department would monitor those outcomes to determine whether, in general terms, the anticipated changes occurred over time or, if not, whether the reasons were known.

28.31 The Department is monitoring a wide range of indicators; however, it does not specifically monitor the intended and unintended impacts of removing the subsidy. The Department believes the range of factors that can affect these indicators makes it difficult, if not impossible, to analyze the results.

28.32 We acknowledge that it is difficult to determine the extent to which ending the subsidy has contributed to crop diversification and the development of value-added processing industries. Nevertheless, the Department needs to be able to answer the questions, “Where is the agriculture sector relative to where it was expected to be after the subsidy ended?” and “Is further action by this department necessary and appropriate?” We believe that it is possible for the Department to determine the direction of change in relevant indicators it anticipates over the long term as a result of ending the subsidy. Then, as part of its ongoing monitoring of these indicators, it needs to assess whether the direction of actual change is as anticipated and, if not, whether the reasons can be determined.

28.33 The Department should:

- evaluate the Western Grain Transition Payments Program to capture lessons for future programs and to assess its impacts, both intended and unintended; and

- assess the direction of changes over the long term related to crop diversification and the development of value-added processing industries in Western Canada.

Department's response: The Department accepts the Auditor General's recommendations.

Agriculture and Agri-Food Canada is proud of the successful implementation and sound financial management of WGTPP and is encouraged by the extent to which the results of the Auditor General's audit acknowledge WGTPP as an administrative success.

The size of this program, the difficulty in obtaining the required data and the need

to get payments out quickly all posed enormous challenges to the Department. It has responded to these challenges in a spirit of fairness and equity while respecting the imperative of fiscal responsibility and the interests of the Canadian taxpayer.

A study has been initiated to identify "lessons learned". The results of this study will be shared broadly within the Department and, as appropriate, throughout the federal government at large.

Review of Interim Transition Payments

28.34 There are two significant areas of the Program's delivery: calculation of payment factors; and verification of applications and calculation of interim payments. We expected to find that payment factors had been calculated in accordance with the Program's enabling Act and regulations and taking into account to the extent possible the fact that

Goal	Comments
1. Fiscal Restraint	A significant reduction in federal expenditures will be achieved. The net present value of continuing the annual "Crow Benefit" of \$560 million in perpetuity is approximately \$7 billion (using an interest rate of 8 percent). Even considering the \$1.6 billion compensation, the \$300 million adaptation fund and the fact that the subsidy would likely be reduced over time, an avoidance of future costs will result.
2. Meeting international trading obligations	The Department advises us that it has concluded that this Program is in full compliance with Canada's international trade obligations.
3. Achieving an efficient, effective grain transportation system	Transport Canada currently has the lead responsibility for this area, which was not within the scope of this audit.
4. Encouraging crop diversification and the development of value-added processing industries	This change has been in progress for some time. The Department has not yet identified what indicators are relevant to track performance, or assessed changes relative to expectations. A project to develop a corporate accountability framework and performance indicators may assist in this regard.

Exhibit 28.5

Changes to Date re Broad Goals of Reform

Even the best available data source was imperfect for the task.

the elimination of the *WGTA* subsidy would affect different landowners in different ways. We also expected to find appropriate controls in place to verify applications and to calculate interim payments.

Calculation of payment factors

28.35 The Department needed to identify data sources to verify applications. Even the best available data source was imperfect for the task and inconsistent among provinces, complicating the Department's development of payment factors. At the same time, the separate allocations to each province helped to reduce the significance of inconsistencies in provincial data. Not all inadequacies could be addressed, given the data available. However, the Department concluded that, in general, the impact of these issues was not that great.

Exhibit 28.6 sets out the three factors, the basis of calculation, and some inadequacies in the data available to calculate each.

28.36 The Department made the conscious decision to avoid making ad hoc changes to payment factors in an attempt to address equity issues. In its view, the factors were reasonable for the purpose intended, and making ad hoc changes could delay payments or could create other problems of equity among landowners or regions. Also, the Department wanted to maintain the transparency and objectivity of the payment factors, which ad hoc changes would diminish.

28.37 One instance where changes were subsequently made involved the adjustment of the payment factors for irrigation, so that irrigated land received higher compensation. The reason for this

Exhibit 28.6

Payment Factors, Calculations and Inadequacies in Underlying Data

Payment Factor	How Factor Calculated	Inadequacies in Data or Calculation	How Inadequacy Addressed
1. Distance	Allocate each parcel of land to the nearest delivery point; the distance from that delivery point to the nearest port is the payment factor	<ul style="list-style-type: none"> Physical barriers (such as rivers) may prohibit delivery to the nearest point Calculates factors to nearest port, not port actually used 	<ul style="list-style-type: none"> Adjustments were made for major barriers Provincial allocation of funds substantially reduced impacts
2. Productivity	In general, calculated using soil type, extent of crop rotations, and yields. Some information was for the particular parcel, some was for the area	<ul style="list-style-type: none"> Inconsistent data among provinces, so calculation varies somewhat by province 	<ul style="list-style-type: none"> Act established separate allocations by province, reducing the impact of data inconsistencies among provinces Smoothing used to reduce anomalies within a province
3. Irrigation	Use one irrigation productivity factor for each province	<ul style="list-style-type: none"> No data for Manitoba 	<ul style="list-style-type: none"> Used highest dryland productivity factor for Manitoba irrigated land

change was that irrigated land, being more productive, would be more affected by the elimination of the subsidy, as the increase in total freight costs per acre of production would be greater.

28.38 Factors used generally provide for consistency within a province.

Before finalizing payment factors, the Department considered alternatives and did substantial analysis of the potential impact of the payment factors it ultimately used. For example, it analyzed the differences in payments per acre between adjacent rural municipalities, and made adjustments to generally keep payments within \$2 per acre in Saskatchewan and Manitoba and \$4 per acre in Alberta for contiguous land parcels within a province and with similar soil.

28.39 Consistency among provinces is not as high as within a province.

Achieving similar payments for similar land across provincial boundaries is more difficult for a number of reasons. First, the legislation governing the Program set separate allocations by province. Further, landowners are eligible for payment if their crops were eligible for the *WGTA* transportation rates, even if a particular landowner never actually shipped grain. In Alberta, the sharing of the Program allocation among a larger base of landowners than those who received *WGTA* subsidies has a greater impact than in the other provinces, since historically a higher percentage of Alberta's crops that were eligible under the *WGTA* subsidy were used for animal feed, not shipped.

28.40 The Department analyzed the significance of cross-province inequities. We reviewed the Department's analysis of parcels of land on either side of provincial borders where parcels have similar soil. We reviewed 10 comparisons of land on the Alberta-Saskatchewan border where, in the Department's view, the soils were

similar; we found a difference in payments of between \$5.58 and \$12.46 per acre. In 10 similar comparisons on the Saskatchewan-Manitoba border the difference was between \$0.62 and \$10.90 per acre.

28.41 The net effect is that application of the payment factors likely results in a high level of payment consistency within provinces but not necessarily among provinces for similar farms. In our view, the calculation of payment factors was reasonable given the fixed provincial allocations, the intended use of the factors, and the time and information available.

Verification of applications and calculation of interim payments

28.42 Interim payment process. The legislation allows interim payments up to 75 percent of the total \$1.6 billion available. This is intended to allow relatively quick payment of the bulk of the compensation, with 25 percent held back to allow for a more detailed review prior to final payment. Between February and June 1996, the Department processed applications and made interim payments of \$1.134 billion, or 71 percent of the total. The Department tried to get as close to 75 percent as possible, while at the same time being conservative in managing the possible risk of overpayment.

28.43 The Department developed and refined a control framework to deal with specific risks that could result in payment errors, and monitored the controls developed to manage the risk and reduce the chance of payment errors.

28.44 Overall review of applications. Even before beginning interim payments, the Department performed checks on the reasonability of the total number of acres applied for. For example, acres applied for (based on the 1994 base year) were

The Department developed and refined a control framework to deal with specific risks that could result in payment errors.

compared with eligible acres reported in the 1991 census. The number of acres applied for was about 3 percent lower than the number shown in the 1991 census and this was deemed reasonable.

28.45 The Department also compared the total number of irrigated acres applied for with available information on total irrigated acres with eligible crops. The number of acres applied for was higher than the total of eligible acres in production. This is significant, since irrigated land has a high productivity factor and consequently receives a higher per-acre payment than dryland acres. As a result, the Department required landowners applying for irrigated acres to provide additional information, including completion of a supplementary application. Based on that information, the Department reduced applications by some 82,000 irrigated acres, or about 11 percent of the total number of irrigated acres applied for. This resulted in redistribution of some \$3.3 million to other applicants, although provincial allocations were not changed.

28.46 Verification of individual applications. There were 210,000 applications involving 730,000 parcels of land. Limitations in the available data

complicated verification. For example, the Department attempted to obtain computerized information on land titles in order to verify ownership. However, this information was not computerized for all regions. Instead, the Department is using two computer edits to help ensure that payments are being made only to landowners. Exhibit 28.7 describes in simplified terms the data sources and reliability concerns that needed to be managed; Exhibit 28.8 outlines the verification procedures.

28.47 Our review of interim payments. We developed audit procedures in conjunction with the Department's Review Branch, and the Review Branch tested a sample of 158 interim payments. We reviewed that work. We also performed our own procedures for areas such as compliance with authorities and computer controls.

28.48 The Review Branch testing found no significant errors. The computer edits had worked as designed, the computer had applied the payment factors selected, and the interim payments made had been calculated as intended.

28.49 Our review covered only interim payments (71 percent of the total to be paid). Given the inherent limitations in the available data and the limited nature of

Exhibit 28.7

Data Sources and Possible Reliability Concerns to Be Managed

Eligibility Rule	Main Data Sources	Reliability Concerns to be Managed
1. Payment to landowner	<ul style="list-style-type: none">● Computerized tax roll records	<ul style="list-style-type: none">● Could be out-of-date or not in the name of the legal owner
2. Payment only for eligible acres	<ul style="list-style-type: none">● Crop insurance records● Land assessment● Satellite imagery developed specifically for this Program	<ul style="list-style-type: none">● Not always available● Categories of crops do not correspond precisely with Program eligibility● Some problems in distinguishing between eligible and ineligible crops

our review, we cannot provide assurance that individual recipients received the correct payment amounts. However, nothing came to our notice in the course of our review to suggest that there were significant problems with the interim Program payments.

28.50 In its procedures to follow up the interim payments, the Department has identified some minor problems and is taking action to deal with them. For example, it identified some cases where landowners had received more as an interim payment than they were entitled to in total. Action is being taken to recover

these amounts, which are relatively small. Other review efforts are continuing beyond the completion of our audit.

28.51 The Department has made arrangements with nine federal departments and agencies to reduce the Program payments to recipients who owe money to the government. As a result, \$10.8 million owed to these other departments and agencies has been recovered to date. In addition, repayment schedules have been arranged with recipients that should result in recovery of an additional \$6.6 million by these departments and agencies.

Nothing came to our notice in the course of our review to suggest that there were significant problems with the interim Program payments.

In simple terms, computer edits compare the eligible acres applied for with the one database of three (crop insurance, land assessment and satellite imagery) that supports the highest number of acres. Then:

- If the database supports a number of acres equal to or higher than applied for, the applicant is paid based on the number of acres applied for. The applicant is never paid for more acres than applied for.
- If the highest database supports a number of acres lower than applied for but the difference is within an allowable percentage, the Department still pays the applicant for the number of acres applied for. The allowable percentage changed somewhat during interim payments, and varied depending on a number of factors including the size of the application.
- If the database supports a number lower than applied for, and the difference is greater than a predetermined tolerance level, there is a downward adjustment and the recipient is paid based on the highest of the three databases. The recipient may file an objection to the adjustment.

Applicants originally applied for compensation based on a total of 78.2 million acres, but after the Department applied its procedures it made interim payments for only 75.9 million acres. Applicants are able to appeal downward adjustments, and some 3,000 applicants appealed, representing about 10 percent of total downward adjustments made. As of the date of our audit completion, the Department was still reviewing these appeals.

Exhibit 28.8

Verification of Eligible Acres



About the Audit

Scope

The main subject of this report is the management of the Western Grain Transition Payments Program. Since the Program is also an integral component of the government's efforts to reform the Western grain transportation system, our audit work was extended to examine the relevant aspects of the broader objectives of this reform initiative. It should be noted that both Agriculture and Agri-Food Canada and Transport Canada have significant roles in these reform efforts. Our audit addressed only Agriculture and Agri-Food Canada and its responsibilities related to those objectives. The government's administration of the WGTA Program and certain matters related to the proposed reform were the subject of an earlier Auditor General's Report in May 1995.

In this audit we did not examine the other programs or changes that occurred as part of the government's overall reform measures, including the \$300 million Western Grain Transition Adjustment Fund, which only began to distribute funds in July 1996.

We also did not attempt to determine whether the \$1.6 billion constituted an appropriate amount of compensation. This is a complex question involving quantitative and qualitative assessments of need, the funding available within the government's fiscal framework, the government's priorities of the day, competing alternative uses for funds and other factors beyond the scope of the audit.

Objectives

We conducted this audit with a view to assessing the adequacy of the design of the Program; the Department's monitoring of potential impacts; the calculation of payment factors; and the verification of applications and calculations of interim payments. Specifically, we:

- assessed whether the Program had avoided the problems associated with a previous federal payout program of a similar magnitude and with similar logistical considerations;
- assessed whether the Department had appropriately considered design alternatives for the Program necessary to implement the decision made by the government in its February 1995 Budget;
- assessed whether the Department was monitoring and evaluating the results or outcomes against those it had expected; and
- assessed whether the payment factors had been calculated in accordance with the Program's enabling Act and regulations, and in a manner consistent with the design decision.

We also performed a limited review of the controls over the interim payments to determine whether any significant problems came to our notice. In particular, we intended to provide limited assurance regarding the Department's verification of applications and calculation of interim payments.

Criteria

We expected that:

- the Program would avoid the well-documented problems associated with previous federal adjustment payout programs;
- the Program's design would consider alternatives necessary to implement the Budget decision;
- the Department would measure and report the extent to which Program objectives and goals related to transportation reform were being achieved; and
- payments would be calculated in accordance with the enabling Act and regulations and appropriate controls would be in place to verify applications and to calculate interim payments.

Audit Team

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**Report of the
Auditor General
of Canada
to the House of Commons**

**Chapter 29
Canadian International Development Agency**

Phased Follow-up of the
Auditor General's 1993 Report – Phase II

Follow-up of the Auditor General's 1994 Report
on Technical Assistance Contributions to Central
and Eastern Europe and the Former Soviet Union

November 1996

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Auditor General's 1993 Report – Phase II

Follow-up of the Auditor General's 1994 Report
on Technical Assistance Contributions to Central
and Eastern Europe and the Former Soviet Union



November 1996

This November 1996 Report comprises 19 chapters, including "Matters of Special Importance", as well as a Foreword and the Main Points from the May, September and November 1996 Report chapters. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.

Chapter 29

Canadian International Development Agency

— Phased Follow-up of the Auditor
General's 1993 Report — Phase II

— Follow-up of the Auditor General's 1994
Report on Technical Assistance Contributions
to Central and Eastern Europe and
the Former Soviet Union

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants.

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Assistant Auditor General: David Rattray
Responsible Auditor: Vinod Sahgal

Canadian International Development Agency

Part I: Phased Follow-up of the Auditor General's 1993 Report — Phase II

Main Points

29.1 In 1993, we reported to Parliament that there was considerable scope to improve the Agency's performance. Our analysis of a sample of bilateral programs and projects showed that in the majority of cases the potential for sustainable benefits from CIDA's expenditures could be questioned.

29.2 CIDA agreed with the thrust of those recommendations aimed at improving the Agency's accountability and strengthening its management effectiveness.

29.3 In 1994, CIDA made a commitment to Parliament to take action on several fronts, as outlined in the CIDA Renewal Plan 1994–1995. This major renewal effort was aimed at transforming the Agency into a more results-oriented, accountable organization.

29.4 A three-phased follow-up approach spanning the three years ending in 1997 was designed to monitor CIDA's effort. An ongoing self-assessment by the Agency on its progress in dealing with concerns raised by the Auditor General was central to this approach.

Our comments on actions reported by CIDA

29.5 Phase I. In 1995, we reported that CIDA had focussed its initial efforts on organizing and planning for renewal mainly at its headquarters. The Agency had developed a results-based management concept to strengthen its effectiveness. We pointed out that it would be timely to implement the new headquarters-developed concepts and policies in the field where the results of the Agency's expenditures are expected to be achieved.

29.6 Phase II. CIDA is committed to achieving improved reporting and transparency relative to its performance. Changes in its organizational culture will be needed to facilitate the process.

29.7 CIDA has introduced a Policy on Results-Based Management and is implementing it. The Agency has since developed a Framework of Results and Key Success Factors for measuring its results at the project level. It has also identified a set of Assessment Tools to enable the Framework to be used by operating personnel. These are the first of several steps required to build an effective performance measurement system. They begin to respond to our concern that the Agency did not have satisfactory procedures to measure and report on its effectiveness.

29.8 CIDA needs to move ahead with courage and determination if it is to realize practical benefits from the new concepts and policies it has devised. At this time, there is a need to:

- clarify how pursuing objectives at the project level contributes toward achieving objectives at the country program level and, as appropriate, the higher-level objectives specified by the government in *Canada in the World*;
- emphasize the application of the Framework and Assessment Tools for ongoing monitoring of results during the implementation stages of programs and projects;
- further improve reporting on performance; and

Main Points (cont'd)

- develop a practical and realistic workplan with a timetable for implementing the System.

29.9 The challenge for the Agency is indeed significant. First, the Bilateral Project Performance Review System for measuring and reporting on results is still in an early stage of development. The System needs to be further developed in consultation with Canadian executing agents and host country institutions and then tested for its suitability by operating personnel in the field. This will take time to implement, given that work on critical aspects, such as the linkage between the information that will be provided by the System and the information reported to Parliament, is not sufficiently advanced. Second, all the key tools needed for strengthening the Agency's management effectiveness and accountability have not yet been fully developed.

29.10 The Agency presented to our Office in October 1996 the status of its progress made toward its renewal, as related to the resolution of concerns raised in our 1993 Report. The scope and timing of our audit work for Phase III will be confirmed subsequently.

Introduction

29.11 Since 1968, CIDA has been the federal government's main arm for administering Canada's Official Development Assistance (ODA). In 1996–97, \$879 million will be spent on bilateral economic and social development assistance. This represents over half the Agency's share of total ODA (Exhibit 29.1). The rest of the ODA provided by CIDA is delivered mainly through funding to multilateral institutions such as United Nations programs, to international financial institutions such as the regional development banks, and to a multitude of non-governmental organizations.

1993 — Our Office raised significant concerns

29.12 In 1993, we audited CIDA's management of bilateral economic and social development programs with a view to:

- providing objective information, advice and assurance to help Parliament scrutinize CIDA's use of its resources and management of its results;
- promoting accountability and good practices by CIDA in managing for results; and
- highlighting areas for improving the Agency's management of its country programs and projects.

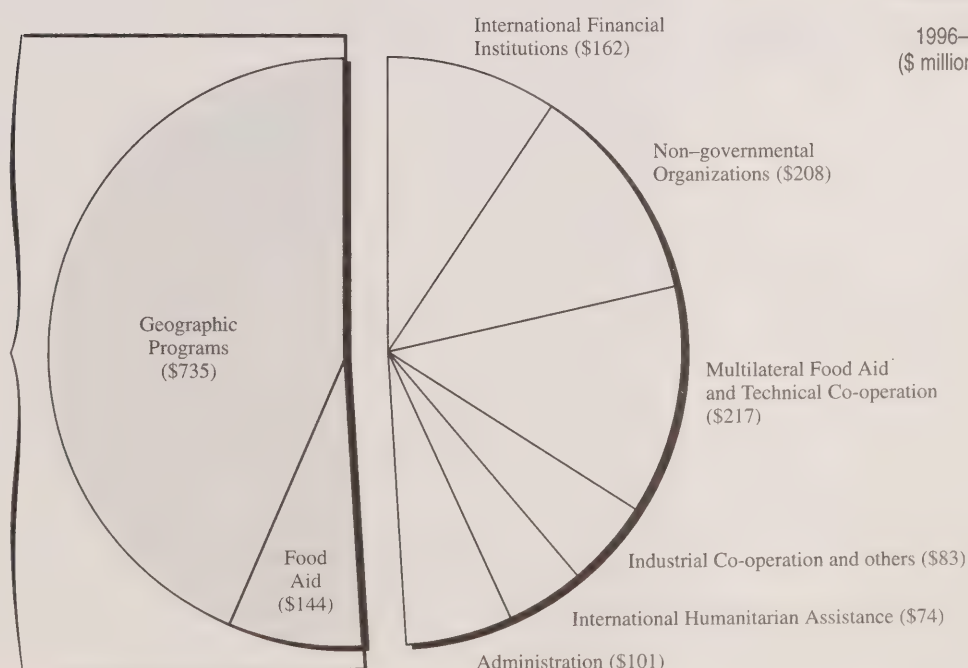
29.13 Our audit coincided with a Strategic Management Review conducted

1993 — We reported to Parliament that there was considerable scope to improve the Agency's performance.

Exhibit 29.1

Main Components of CIDA's Share of Official Development Assistance

1996–97
(\$ millions)



Bilateral economic and social expenditures (\$879 million) represent over one half of CIDA's share of Official Development Assistance (\$1.724 billion)

Source: CIDA Part III Main Estimates 1996–97

1994 — CIDA made a commitment to Parliament to take action on several fronts.

by the Agency at the request of its Minister. Both examinations identified some important lessons from CIDA's 25 years of experience — in particular, the need for the Agency to improve its base of knowledge on development needs and approaches, increase the relevance of its aid program through better dialogue with its stakeholders, and reduce its delivery costs.

29.14 We reported to Parliament that there was considerable scope to improve the Agency's performance. Our analysis of a sample of bilateral programs and projects showed that in the majority of cases the potential for sustainable benefits from CIDA's expenditures could be questioned.

29.15 The Main Points of our 1993 audit and the conclusions we reached are outlined in Exhibit 29.2.

29.16 CIDA agreed with our 1993 findings and with the thrust of those

recommendations aimed at improving its accountability and strengthening its management effectiveness. The Agency committed itself to taking action to address those recommendations.

1994 — CIDA made commitments toward its renewal effort

29.17 In 1994 CIDA made a commitment to Parliament to take action on several fronts, as outlined in the CIDA Renewal Plan 1994–95 aimed at transforming the Agency into a more results-oriented, accountable organization. The plan for this effort incorporated the actions necessary to address the concerns raised in our 1993 Report. The Agency provided this plan to the House of Commons Standing Committee on Public Accounts in the spring of 1994, following the Committee's hearings on our 1993 Report on CIDA.

29.18 During 1994, officials of the Agency also testified at the Standing

Exhibit 29.2

Main Points in the 1993 Report

- Official Development Assistance is a significant aspect of Canada's foreign policy. For 25 years CIDA has been the main conduit for delivering development assistance. Annual expenditures for bilateral economic and social development assistance exceed one billion dollars.
- We conducted this audit taking into account the increasing international awareness that continued investment in development projects that are not likely to be sustained beyond donors' financial assistance represents a questionable use of scarce resources.
- In its ability to meet development needs of the nineties, the Agency has been losing ground. Current performance has not maximized the use of resources and has not led sufficiently to self-reliant development. There is considerable scope to improve CIDA's performance in promoting enduring benefits from its investments.
- CIDA's bilateral programs need to concentrate more on those countries and activities where there is the greatest potential.
- Lessons learned from 25 years' experience show a need to resolve conflicts among multiple objectives and to establish a more results-oriented, focussed, businesslike and accountable style of operation. They also call for dedication to the basic objectives, such as fighting poverty and helping people help themselves, that Canada has affirmed repeatedly over many years.
- None of these changes will be easy to make, since they will require a change in mindset, skills and culture, and strong ministerial support. Their successful implementation will depend on the will to reform, not only among management and staff of the Agency but also among those who act as its development partners, in Canada and in the developing countries where CIDA operates.

Committee on Foreign Affairs and International Trade. Both committees expressed interest in CIDA's renewal effort. The Special Joint Committee Reviewing Canadian Foreign Policy recommended that the House of Commons Standing Committee on Foreign Affairs and International Trade or the Senate Foreign Affairs Committee hold regular reviews of CIDA's performance. Accordingly, further hearings could be expected to monitor the implementation of its renewal effort.

1994 — An innovative approach was developed: phased follow-up

29.19 A three-phased follow-up approach spanning the three years ending in 1997 was designed to monitor CIDA's efforts (see Exhibit 29.3). An ongoing self-assessment by the Agency of its progress in dealing with concerns raised by the Auditor General was central to this approach. This follow-up work provides a mechanism for a continuing dialogue

among Parliament, CIDA and our Office on an important aspect of Canadian foreign policy.

29.20 The phased follow-up approach was designed to reinforce CIDA's accountability to Parliament. It was intended to foster greater acknowledgement by a department or agency of the concerns raised by the Auditor General and a greater commitment to implementing measures to address them.

29.21 Our main objectives for the three-phased follow-up audit reports were to provide management and parliamentarians with a review of CIDA's self-assessment; to promote transparency in CIDA's ongoing efforts toward renewal; and to assist the concerned parliamentary committees in monitoring CIDA's progress, assessing changes in directions (trade-offs) and providing support.

29.22 We also believed that this approach would enable our Office to be

1994 — The three-phased follow-up approach provides a mechanism for a continuing dialogue among Parliament, CIDA and our Office.

The phased follow-up audit was planned to be carried out in three phases :

- Phase I consisted of two parts: first, the Agency's self-assessment of the actions taken as part of its renewal to address the principal concerns raised in the 1993 Report; and second, the development of a Performance Measurement Model (now called Bilateral Project Performance Review System) by CIDA. The 1995 chapter provided the results of the first part of Phase I, the Agency's self-assessment, as well as our comments. The second part, the development of a prototype Bilateral Performance Measurement Model, was under way at the time of writing this chapter.
- Phase II was to cover CIDA's progress in implementing the model (Bilateral Project Performance Review System) it is developing to measure and report on the performance of its bilateral programs and projects. It was to consist of CIDA-led pilot projects to illustrate the application of this model (completed in the second part of Phase I) in the field. This work began in the fall of 1995. It was proposed that CIDA's self-assessment on the results of Phase II, as well as our comments, be provided to Parliament in the Auditor General's 1996 Report. To aid us in commenting on CIDA's self-assessment, we were to participate alongside CIDA's staff in the field in examining the feasibility of CIDA's model for assessing the Agency's projects and programs.
- Phase III, in which we plan to follow through on our 1993 work and report to Parliament in the future, will consist of an audit of selected country programs and projects. To the extent that CIDA's performance measurement model (Bilateral Project Performance Review System) is judged acceptable by us, we intend to use it in the audit. The audit will focus on the measurement of CIDA's results, particularly its programs, projects and the systems and procedures for reporting to the Minister and Parliament on the Agency's performance.

Exhibit 29.3

Phased Follow-up Approach

more efficient by directing its attention to new or continuing concerns, and by building constructive working relations among CIDA, Parliament and our Office. In addition, we expected that the approach would serve potentially as a model for other organizations.

29.23 The methodology adopted for the phased follow-up audit is described in Exhibit 29.4.

1995 — Our comments on actions reported by CIDA (Phase I)

29.24 In 1995, the government statement *Canada in the World* stated that the government would pursue foreign policy to achieve three key objectives:

- the promotion of prosperity and employment — this is at the heart of the government's agenda;
- the protection of our security, within a stable global framework — the promotion of global peace as the key to protecting our security remains a central element of our foreign policy; and
- the projection of Canadian values and culture.

29.25 *Canada in the World* also defined a policy framework setting out four key commitments for Canada's Official Development Assistance program. Those commitments are a clear mandate and set of priorities, strengthened development partnerships, improved effectiveness, and better reporting of results to Canadians.

29.26 Within a clear mandate and set of priorities in this framework, the government stated, "The purpose of Canada's ODA is to support sustainable development in developing countries, in order to reduce poverty and to contribute to a more secure, equitable and prosperous world." To achieve this purpose, Canada's ODA is to concentrate available resources

on the following six program priorities: basic human needs, women in development, infrastructure services, human rights, democracy and good governance, private sector development, and the environment.

29.27 In *Canada in the World*, the government committed itself to improve the effectiveness of Canada's Official Development Assistance. The government would take a number of steps to improve CIDA's operational efficiency. It would also work to strengthen coherence among foreign policy instruments pertaining to developing countries, and focus its efforts on a limited number of countries while maintaining programs in other countries through low-cost, administratively simple delivery mechanisms.

29.28 In 1995, we noted in the Phase I Report that our principal concerns, namely accountability and management effectiveness, were being addressed initially at CIDA's headquarters. We pointed out that the primary focus had been on organizing and planning for renewal. The emphasis had been mainly on developing a consensus among headquarters management on changes to the Agency's organizational structure, policies, management practices, skills and training requirements. An Agency-wide Policy on Results-Based Management was being prepared at the time. Many of the tools required to implement the policy were in varying stages of development. CIDA's senior management had discussed ways to implement results-based management and the need to develop a reporting system that best supported this initiative.

29.29 We felt that the next steps were even more crucial. We pointed to the need to implement the new policies and practices effectively, particularly in the field. We also noted the need to accelerate

Exhibit 29.4

Phased Follow-up Audit
Methodology

Three Phases

Phase I
1995



September 1994–July 1995

Interim Audit Objective

To assess whether CIDA is addressing our principal concerns

Two Parts:

- 1) CIDA's self-assessment of actions taken to address the concerns raised in the 1993 Report and Auditor General's comments on whether our principal concerns are being addressed
- 2) Development of a prototype *Bilateral Performance Measurement Model* by CIDA

provided to Parliament
in 1995 Report

Phase II
1996



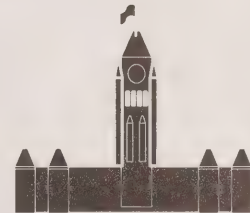
September 1995–July 1996

Interim Audit Objective

To assess whether CIDA's renewal is being implemented in the field as planned

Two Parts:

- 1) CIDA-led pilot projects to illustrate application of the *Bilateral Performance Measurement Model* in the field
- 2) CIDA's self-assessment of Phase II results along with Auditor General's comments



provided to Parliament
in present 1996 Report

Phase III

Final Audit Objective

To assess the quality of CIDA's programs and projects and reporting thereon. In this context we will also formulate an opinion on the extent to which CIDA's actions have satisfactorily resolved concerns raised in our 1993 Report.

Two Parts:

- 1) Auditor General's audit of selected country programs and projects
 - Focus on the measurement of CIDA's results, particularly its projects and the systems and procedures for reporting to the Minister and Parliament
- 2) Auditor General's opinion on the extent to which CIDA's actions have satisfactorily resolved concerns in the 1993 Report

to be provided to
Parliament in a future
Report

CIDA stated that it would concentrate on ensuring that its reforms would be translated into program delivery in the field.

the development of indicators or criteria that are simple and usable (that is, understandable and practical) for measuring and reporting on the Agency's results and on the success of its programs and projects.

29.30 The main points in our 1995 Report are set out in Exhibit 29.5.

29.31 CIDA stated that it would concentrate on ensuring that its reforms would be translated into program delivery in the field. The Agency was confident that the continuation of its renewal effort over the next two years would lead to the satisfactory resolution of the main concerns raised in our 1993 Report.

Steps taken in conducting Phase II

29.32 Our Phase II follow-up consisted mainly of a review of the information provided in CIDA's report titled

"Improving Effectiveness: Building CIDA's Results Measurement System".

29.33 We reviewed the report for clarity and completeness, and to determine whether it accurately reflects the progress CIDA is making in building its Bilateral Project Performance Review System.

29.34 In preparation for this review, we held discussions with the appropriate CIDA personnel at headquarters and in the field. We analyzed various documents provided to us that supported the content of CIDA's report. We also attended a workshop organized by CIDA and the International Development Research Centre, in consultation with our Office. The workshop was held in Ottawa in May 1996 on the subject of performance measurement in the context of Official Development Assistance.

29.35 CIDA presented to us in October 1996 the current status of its progress since 1995 (Phase I) toward

Exhibit 29.5

Main Points in the 1995 Report

- CIDA's self-assessment report addresses the principal concerns raised in our Report. The Agency has developed a results-based management concept to strengthen its effectiveness. The clarity with which CIDA has acknowledged its accountability to Parliament for results and the emphasis it is placing on coherence in pursuing the government's priorities in Official Development Assistance are noteworthy.
- Insightful analysis of Canada's strengths and how they correspond with developing countries' needs, as well as courageous decisions, will continue to be required to achieve the policy objectives set by the government.
- The need remains for developing a contracting approach that defines the respective accountabilities and risks of both CIDA and its executing agents in the new context of results-based management.
- There is also a call for greater transparency. Canadians want to be sure that their aid dollars are being used effectively — that their help is making a difference in the lives of people benefiting from Canadian assistance by increasing their self-reliance.
- It would therefore be timely to accelerate the development of indicators that are simple and usable for measuring and reporting on the Agency's results. Any further delay in this area could well adversely impact on CIDA's credibility. CIDA needs a comprehensive tracking and reporting system to assess the quality and status of its projects.
- The report on Phase II of the "phased follow-up", due in 1996, will focus on how successfully CIDA has commenced implementing its results-based management concept in the field.
- In a time of substantial budget cutbacks, it is more important than ever that CIDA be in a position to demonstrate to Parliament which of its channels and program instruments are yielding the best results in achieving those objectives that have the highest priority.

resolving all the concerns raised in our 1993 Report. The nature, extent and timing of our audit work for Phase III will be confirmed subsequently (see section: Proposed Audit Plan for Phase III).

1996 — Our Comments on Actions Reported by CIDA (Phase II)

29.36 CIDA's report — Improving Effectiveness: Building CIDA's Results Measurement System — focusses on the Agency's progress since Phase I concerning the process it used in building the Bilateral Project Performance Review System (the System) for assessing its bilateral projects. The System is presented as one of the major initiatives the Agency is undertaking for transforming itself into a results-oriented and learning organization. This initiative begins to respond to the long-standing concern that the Agency needs to strengthen its procedures for measuring and reporting on its program effectiveness.

29.37 In its report, CIDA explains that the Bilateral Project Performance Review System consists mainly of a Framework of Results and Key Success Factors (Framework) and a set of Assessment Tools (Tools), designed to enable CIDA and its partners to satisfy the information requirements of the Framework. The Agency states that the Framework is the core of the System and the first step required to develop and operationalize a functioning bilateral performance review system.

29.38 CIDA's report further outlines the various other initiatives the Agency is undertaking and those it is planning to undertake in relation to the development and implementation of the System. It also draws attention to difficulties surrounding

the provision of Official Development Assistance identified by CIDA in 1993.

29.39 The report provides Parliament with information on the extent of progress CIDA has made since Phase I toward strengthening its procedures for measuring and reporting on its effectiveness. For example, the report points out that CIDA has introduced its Policy on Results-Based Management, which it has recently started to implement. The report clearly presents the Agency's Framework of Results and Key Success Factors. Key questions that will be raised are listed. For example, what progress is being made toward achievement of results? The elements of the Framework are also clearly stated; for example, the extent to which actual expenditures correspond to planned expenditures is recognized as a factor in measuring performance. The report also refers to key additional steps that CIDA will take, such as training and skills development for staff, development of operational guidelines, development of a workplan on the design of a databank, and further work on indicators for measuring performance.

29.40 CIDA points out that there are constraints that must be recognized. For example, effective performance measurement, in its view, has become more complex in recent years, donor agendas have expanded to include new countries, and "softer" social development initiatives are under way in complex areas such as capacity building, institutional development, democratic development, and human rights. In addition, the focus of measuring performance has shifted from inputs (resources provided) to results. The report explains that measurement processes should be participatory (that is, ongoing involvement of stakeholders is critical) if the Agency's objectives of performance measurement are to be

The Bilateral Project Performance Review System consists mainly of a Framework of Results and Key Success Factors and a set of Assessment Tools.

In our view, the emphasis now needs to be on implementing the Agency's approach to measuring its results and on meeting related reporting requirements.

There is a need to clarify the responsibility of line staff for setting achievable objectives, achieving results and reporting thereon.

achieved. These objectives include enhancing its ability to learn from experience, improving decision making in areas such as resource allocation, and better reporting on the Agency's results.

29.41 The Agency has designed an approach to measuring its results. In our view, the emphasis now needs to be on implementing this approach and on meeting related reporting requirements. In this context, the following comments warrant CIDA's attention at this time.

29.42 There is a need to clarify:

- how pursuing objectives at the project level contributes toward achieving objectives at the country program level and, as appropriate, the higher-level objectives specified by the government in *Canada in the World*; and
- the responsibility of CIDA's line staff for setting achievable objectives, achieving results and reporting thereon.

29.43 In *Canada in the World*, the government sets out three objectives: the promotion of prosperity and employment; the protection of our security, within a stable global framework; and the projection of Canadian values and culture. It states that these objectives are interrelated and mutually reinforcing. They will guide decisions on priorities and on the allocation of resources. Of these objectives, the promotion of prosperity and employment is at the heart of the government's agenda. The government further states that international assistance is a vital instrument for the achievement of these objectives. It is therefore important that the procedures for measuring and reporting program effectiveness are capable of developing information on how CIDA's performance contributes to these higher-level objectives, to the extent that it is reasonable and appropriate.

29.44 The Framework allows for the reporting of benefits to Canada. While this is not an explicit policy objective, the Agency may also greatly contribute to the success of Canadian firms who have, over the years, reduced their dependence on government and expanded and diversified their international business contacts.

29.45 In order for CIDA to assess performance against its objectives at the project and country program level more systematically, it needs to consistently track data that provide information on its performance. The Agency needs to more fully address constraints, if any, that impede its rate of progress. It should have analytical information available on a consistent basis on its performance in such areas.

29.46 CIDA states that results will be reported for projects and for its six priorities as stated in *Canada in the World*. The purpose of the Results section of the Framework is to capture the essential information to report performance on these priorities. The Minister allocates funds given to the Agency, on a country or region basis. Therefore, for the effective use of the Framework, it will also be necessary to explain more explicitly the contribution made by the results at the project level toward the results expected at the country or region level. In addition, it will be necessary to further explain how the results at the country or region level contribute to the results at the level of program priorities and objectives enunciated in *Canada in the World*.

29.47 In referring to the accountability of CIDA managers with respect to managing for results, CIDA's progress report states the Key Principles of the Agency's Policy on Results-Based Management. One of these is that individuals accept their responsibility for delivering results. For the Framework to

be used effectively, CIDA will have to clarify the related responsibilities necessary for setting objectives and achieving related results and assign and communicate them clearly to the various levels of staff within the Agency and to its partners.

29.48 There is a need for greater emphasis on the use of the Framework and Tools for ongoing monitoring of projects.

29.49 The greatest value of the Framework in the context of strengthening management effectiveness is in its use for ongoing monitoring. Use of the Framework for measuring project results on a post-completion basis will be difficult unless accompanied by ongoing monitoring during project delivery. Accordingly, specific tools for monitoring performance at appropriate milestones, which managers can use throughout project delivery, should be emphasized in the Bilateral Project Performance Review System. In this regard, CIDA could benefit from the practices of other international organizations that place equal if not greater emphasis on monitoring the potential for results during project delivery, as opposed to after the project is completed and funds have been disbursed.

29.50 There is a need to further improve reporting on performance.

29.51 In 1995, CIDA indicated its commitment to improve its reports to Parliament and to increase its focus on objectives and achievements of results. CIDA stated that its Part III of the 1995–96 Estimates presented more clearly information on the Agency's program objectives and priorities, and described its approach to achieving and demonstrating development results. CIDA also indicated that in future years, improved

performance review information will further strengthen its ability to report to Parliament on results being achieved.

29.52 CIDA's report states that *Canada in the World* committed the Agency to achieving improved reporting to Parliament and the public on the results of its development efforts. CIDA points out that its section of the 1996–97 Main Estimates reports on disbursements and results across all programming channels according to the six ODA priorities. The Agency identifies additional vehicles for reporting information on CIDA initiatives to parliamentarians and the Canadian public.

29.53 CIDA is committed to preparing periodically in the future a performance report to Parliament, as part of the Expenditure Management System of the Government of Canada. To prepare such a report, it will need to rely on information provided by the System. Therefore, it will be necessary to establish a linkage between the information that will be provided by the System and the information reported to Parliament.

29.54 In commenting that there is a need to further improve reporting on performance, we are not suggesting that the information for Parliament should be in as much detail as the information required for its senior management and the Minister. Nor are we suggesting that the System should be the only source of information for external reporting. What we are suggesting is that it would be timely to determine an approach to reporting on performance that meets the needs of the Minister, concerning how well the Agency's country programs and projects are performing against his expectations, as well as the needs of parliamentarians seeking summary information on the overall performance of the Agency.

The greatest value of the Framework in the context of strengthening management effectiveness is in its use for ongoing monitoring.

Changes in the Agency's organizational culture will be needed to facilitate the process of improving reporting and transparency in relation to its performance.

There is a need to identify a mechanism for co-ordinating implementation of the Bilateral Project Performance Review System at the Agency level.

29.55 Changes in the Agency's organizational culture will be needed to facilitate the process of improving reporting and transparency in relation to its performance.

29.56 There is a need for a practical and realistic workplan with a timetable for implementing the Bilateral Project Performance Review System.

29.57 The Agency's current implementation strategy is based on the premise that CIDA needs to learn by doing "as it integrates the System into everyday work." The Agency intends to review progress after one year. Accordingly, the users of the System need to accept responsibility for its implementation.

29.58 We have two concerns at this time. Our first concern is that a workplan for implementation needs to be prepared. The responsibilities of line managers for the various required activities need to be specified. CIDA has identified the vice-presidents of its geographic branches as the champions for implementing the System. It is therefore important that they be fully committed to the System, in particular its Framework and the Tools.

29.59 The Agency recognizes that program and project managers will need to play a key role in developing and implementing the System. Their willingness to take charge can be a first test of the likelihood that the field will accept its implementation.

29.60 Our second concern is the need to ensure that the efforts in the various branches are well co-ordinated. Given the wide dispersion of CIDA's programs and projects, there is a risk that difficulties encountered in the implementation stage may go undetected and/or that corrective actions may not be taken on a timely basis. Similarly, lessons learned in one

branch will need to be shared with other branches.

29.61 In summary, to implement the System as intended, there is a critical need for a clear implementation strategy and also for a practical and realistic workplan for implementing it at the geographic branch level. Furthermore, there is a need to identify a mechanism for co-ordinating implementation at the Agency level.

29.62 There is a need for an early "buy-in" by all the key partners in development (for example, Canadian executing agents and host country institutions), because ultimately they will have to capture and share the necessary information to make the System work effectively.

29.63 CIDA's projects are delivered by third parties such as Canadian executing agents under contract with the Agency. The answerability of CIDA must be viewed in the context of the chain of accountability established with those third parties engaged in the delivery of CIDA's programs and projects. The need remains to finalize a contracting approach that clearly defines the respective accountabilities and how risks will be shared between CIDA and its partners.

29.64 The Agency is beginning to engage its agents in testing the Project Completion Report it has designed. These agents need also to be engaged in the design and testing of related reporting formats for ongoing monitoring. In addition, it will be necessary to specify what results-oriented information is expected to be gathered by these agents, what kinds of actions may be required based on the new information that is revealed by the operation of the System, and what reports must be filed and how frequently. In this regard, a consultation process has begun. It is too early, however, for us to assess what changes to

the contracting arrangements will be necessary for implementing the System or what the additional costs are likely to be.

29.65 Host country institutions and the people receiving the assistance are also key stakeholders. They too have a role to play in developing and providing information that is necessary for monitoring and evaluating the progress of CIDA's projects. CIDA will need to seek their participation in the measurement and reporting process envisaged at this time. Experiences of many development agencies point toward the importance of involving stakeholders at all stages of the project, particularly in collecting baseline information at the project appraisal stage as well as during the life cycle of the project.

29.66 The question is, how quickly can CIDA obtain the necessary "buy-in" of its partners and ultimate beneficiaries in the design of its System? The perception of the costs and benefits to them of participating in the System will likely be a deciding factor.

29.67 **There is a need to further emphasize the principle of "simplicity" as a key theme to pursue.**

29.68 In our view, there is a need for a balance between how much information should be gathered and the cost of gathering it. We share the concern expressed by many line managers and operating personnel that the Bilateral Project Performance Review System not be too onerous. Simplicity must remain a central objective. If line managers are to buy into performance measurement, the System must be useful to them. It will need to provide information that they see as helping them to improve the quality of what is being delivered.

29.69 The Agency has accepted our suggestion to use a risk-based approach for determining the nature and extent of information that it will gather for measuring performance. For example, not all the factors need to be applied in every situation. CIDA has also agreed to review periodically the costs and benefits associated with the application of the Framework and Tools that have been or are being developed in consultation with its stakeholders.

29.70 In summary, the Agency may wish to continue encouraging a more qualitative and selective approach to measurement of performance in order to meet its primary requirements without adding to the complexity of the development process. These requirements are the need to maximize the potential for program and project results, and the need to provide appropriate information for reporting to the Minister and Parliament on the quality of the investments that CIDA is making and on the results and accomplishments of the Agency.

Conclusion

29.71 CIDA has introduced a Policy on Results-Based Management and is implementing it. The Agency needs to move ahead with courage and determination if it is to realize practical benefits from the new concepts and policies it has devised.

29.72 The Bilateral Project Performance Review System for measuring and reporting results is still in an early stage of development and its usefulness is largely untested. Implementation trials in the field are just beginning.

29.73 The System needs to be further developed in consultation with Canadian executing agents and host country

The question is, how quickly can CIDA obtain "buy-in" of its partners and ultimate beneficiaries in the design of its System?

The Bilateral Project Performance Review System is still in an early stage of development and its usefulness is still largely untested.

institutions and then tested for suitability by operating personnel in the field. Their concerns will also have to be addressed. Moreover, all this will take time to implement. In addition, it will be necessary to establish a linkage between the information that will be provided by the System and the information reported to Parliament. As well, the key tools needed for strengthening the Agency's management effectiveness and accountability have not been fully developed.

29.74 The Agency has been updating its status on the progress made toward its renewal. The outcome of this exercise was made available in October 1996. At this time we are not in a position to assess whether CIDA's renewal effort is being implemented in the field as planned.

29.75 The challenge for the Agency is to achieve all it set out to do within the timeframes to which it committed to Parliament in 1995.

Proposed Audit Plan for Phase III

29.76 Audit objective. The audit objective will be as it was in 1993, that is, to assess the quality of CIDA's programs and projects and the reporting thereon. The audit will be results-oriented. In this context, we will formulate an opinion on the extent to which CIDA's actions have satisfactorily resolved the main concerns raised in our 1993 Report. The audit will be conducted in accordance with the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants.

29.77 Scope and approach. Our focus will be on CIDA's accountability to

Parliament for managing for results. In this context, we will place special emphasis on the procedures used for measuring and reporting results within the Agency, to the Minister and to Parliament.

29.78 We will also examine the extent to which the Agency has strengthened its procedures to obtain independent assurance that its moneys are spent by third parties (on its behalf) exclusively for the purposes intended.

29.79 We propose to examine in depth a sample of country programs and projects to assess the quality of the results achieved or the potential for achieving results. For our consideration in planning our audit, we have asked CIDA to identify country programs and projects that it believes best demonstrate the improvements brought about from its renewal. We will first examine in Canada the procedures used for measuring and reporting the results of these programs and projects, as well as those of other countries we may select, before extending our examination into the field. We propose to conduct pilot examinations in two countries before extending our audit work.

29.80 Our examination in the field will take place at the Canadian missions and project sites. It will include consultations with stakeholders, such as Canadian and local executing agents, host country institutions and target groups of people in developing countries.

29.81 We will look to best practices enunciated by organizations such as the Organization for Economic Co-operation and Development (OECD) to test the appropriateness of the criteria we propose to use for drawing our conclusions. We will also consult, as necessary, with our counterpart audit offices in co-operating countries.

29.82 As appropriate, we will assess the extent to which the key concerns raised in our 1993 Report have been satisfactorily addressed. We will supplement our project audits by relying on audits and evaluations conducted by the Agency, where feasible.

29.83 In addition, if we find that some of the main concerns we raised in 1993 have not been dealt with satisfactorily, we will try to assess for Parliament the consequences and what some of the obstacles might be.

29.84 Criteria. The Minister is accountable to Parliament for measuring and reporting on the results of CIDA's programs and projects. The Minister's accountability must take into account that, in practice, CIDA cannot be expected to be successful in every activity it undertakes.

29.85 We recognize that CIDA cannot be held solely accountable for the outcomes or impacts of its programs and activities in developing countries. This is because it does not have control over the political and economic environment or the behaviour of other stakeholders, such as

host country governments and the beneficiaries, that may affect outcomes and impacts. But CIDA is answerable for the way in which it uses its resources to take actions that should lead to progress toward its objectives. CIDA is also answerable for taking prudent action to change its objectives and activities when unanticipated or uncontrollable events render them unrealistic. Similarly, in our opinion, CIDA has a duty to report periodically to its governing bodies and the public on its program performance and, as appropriate, on its project results.

29.86 The Framework of Results and Key Success Factors provides guidance for the development of audit criteria. In this regard, the criteria we propose to focus on at the country and project levels are provided in Exhibit 29.6. These criteria will be modified as appropriate during the audit.

29.87 Timeframe. The audit was scheduled to start in October 1996. We plan to include the results of our audit in a future Report of the Auditor General of Canada to the House of Commons.

Exhibit 29.6

Audit Criteria

At the Country Program Level

In referring to the accountability of CIDA's managers with respect to managing for results at the country program level, criteria such as the following will be applied.

We expect managers to do the following:

Strategic Objectives

- actively pursue well-defined policy and objectives that can be reasonably achieved

Risk Management

- assess and manage the risks associated with the programs, projects and related activities

Performance Management

- obtain and use relevant information on performance
- understand and evaluate to what extent programs and activities are meeting the Agency's performance expectations
- continually learn from their experience and redirect resources more productively among programs and projects

Reporting on Program Performance

- report on costs and accomplishments in terms of results

Learning Organization

- create an action-oriented organizational environment that promotes learning by doing, an innovative style of management and an openness to differing viewpoints

At the Project Level

In referring to the accountability of CIDA's managers with respect to managing for results at the project level, criteria such as the following will be applied.

We expect managers to do the following:

Results Achievement

- set objectives that can be reasonably achieved
- know whether project partners are achieving (or likely to achieve) planned results

Ongoing Relevance and Appropriateness

- know whether the project is of ongoing relevance and whether the intervention continues to be appropriate

Sustainability

- know whether project results are likely to provide sustainable benefits after CIDA's direct funding comes to an end

Cost Savings

- know whether costs of implementation are being minimized without sacrificing results achievement

Timely Corrective Actions

- take timely actions to improve project performance (by addressing criteria # 1, 2, 3, and 4)

Reporting on Project Performance

- report to CIDA's senior management periodically on the potential for results and the need for corrective actions taken where appropriate
- provide assurance that money has not been expended for purposes other than for which it was appropriated by Parliament

Canadian International Development Agency —
Improving Effectiveness:
Building CIDA's Results Measurement System



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Mr. Denis Desautels
Auditor General of Canada
240 Sparks Street
Ottawa, Ontario
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Dear Mr. Desautels:

I am pleased to transmit to you, under cover of this letter, the self-assessment report prepared by the Canadian International Development Agency (CIDA). This report is CIDA's contribution to the Follow-through Chapter in your November 1996 Report to Parliament.

This self-assessment report provides, in my opinion, a fair and complete assessment of the progress CIDA has achieved in designing and implementing a bilateral project performance review system. In doing so, it responds to the concerns raised in your 1993 Report to Parliament regarding CIDA's procedures for measuring and reporting on effectiveness.

I would like to take this opportunity to express my appreciation to you and the members of your team for your encouragement and support. We look forward to continued collaboration and co-operation throughout the next phase of our work together.

Yours sincerely,



Hugnette Labelle

Canada

Introduction

29.88 In 1994, CIDA initiated a program of renewal. The program was aimed at making CIDA a more results-oriented organization in order, ultimately, to improve its development effectiveness. The renewal process signalled that CIDA would become more methodical in improving its results-based management (RBM) practices. Over the past year, the Agency has accomplished the following:

- CIDA has introduced a Policy on Results-Based Management (RBM Policy was approved in March 1996) and is now implementing it. The Agency will be launching an RBM training and skills development program.
- CIDA is putting in place a performance measurement system that will encompass project design, monitoring, completion reporting, evaluation, and audit.
- CIDA has developed, tested and commenced implementing a Framework of Results and Key Success Factors (the Framework) for assessing the performance of its bilateral projects (the Framework was approved in July 1996).
- CIDA has started to plan a performance database and to work on indicators.

29.89 CIDA's achievements have taken place at a difficult time for the international donor community. In the 1990s, the provision of development assistance has faced an increasingly volatile and uncertain global environment. Aid budgets have been declining. At the same time, donor agendas have expanded to include new countries and "softer" social development initiatives in complex areas such as capacity building, institutional development, democratic development, and human rights. There is

no international consensus on how to measure performance in these areas. In focussing more on the measurement of development results, many donors are grappling with the challenges of moving from measuring inputs to managing for outcomes and longer-term impacts. The challenge of attributing these results to donor interventions remains a formidable one.

29.90 There is a growing recognition that, to be effective, monitoring and evaluation must involve all partners in the development process, including CIDA managers, contractors, recipient partners, and beneficiaries. Measurement processes should be participatory, which takes time and requires new skills. As a result, effective performance measurement has become more complex.

29.91 The difficulties surrounding the provision of Official Development Assistance and measuring its effectiveness were identified by CIDA and mentioned in the Auditor General's report on CIDA in 1993. There are no blueprints and no easy answers. Nevertheless, CIDA feels that the improvements it is making and will be making in its own results measurement systems, as outlined in this report, will enhance its ability to learn from experience, improve decision making, and better report on its results.

Purpose and Scope of Self-Assessment

29.92 The scope of this Phase II self-assessment is:

- "to cover CIDA's progress in implementing the model it is developing to measure and report on the performance of its bilateral programs and projects. It will consist of CIDA-led pilot projects to illustrate application of its Performance Measurement Model (completed in the second part of Phase I) in the field."

CIDA has introduced a Policy on Results-Based Management and is putting in place a performance measurement system.

This report focusses on CIDA's progress in building a system for assessing its bilateral projects.

A results-based management training and skills development program for CIDA staff will be launched, operational guidelines will be developed, and a workplan on the design of a databank on performance information is now under way.

(Report of the Auditor General of Canada to the House of Commons, October 1995, Chapter 13, excerpt from para. 13.9)

29.93 This self-assessment is CIDA's part of the second phase of a three-phased follow-up approach to report on the Agency's actions in learning from and building upon recommendations contained in the 1993 Report of the Auditor General of Canada. In its 1995 Phase I self-assessment, CIDA reported on the renewal initiatives it was undertaking to address the Auditor General's 1993 recommendations.

29.94 This report focusses on CIDA's progress in building a system for assessing its bilateral projects. This is a major initiative in transforming the Agency into a results-oriented and learning organization. In doing so, work on the system addresses a number of concerns raised in the Auditor General's 1993 Report on CIDA and builds on progress reported in the 1995 self-assessment. In particular, it helps the Agency to institutionalize lessons learned, and to increase the potential for project sustainability by providing criteria and tools for project appraisal and a better focus on results. The system also contributes to upgrading CIDA's performance review capabilities in evaluation, internal audit and assessment, and increased transparency of its intended and actual results.

Exhibit 29.7

CIDA's Results-Based Management Policy Statement

"Results-based management is integral to the Agency's management philosophy and practice. CIDA will systematically focus on results to ensure that it employs management practices which optimize value for money and the prudent use of its human and financial resources. CIDA will report on its results in order to inform Parliament and Canadians of its development achievements." (Policy on Results-Based Management. March 1996)

A Better Focus on Results: Results-Based Management and Renewal Initiatives at CIDA

29.95 In 1996, CIDA introduced an RBM Policy (see Exhibits 29.7 and 29.8) to provide its staff and partners with clear and coherent guidelines and to signal the beginning of a more systematic approach to the implementation of results-based management in CIDA. A Senior Management Committee, chaired by the President, oversees the implementation of the Policy.

29.96 The RBM Policy provides a definition of what CIDA means by results:

- A **result** is "a describable or measurable change in state that is derived from a cause-and-effect relationship."
- CIDA achieves developmental results in a sequential **results chain** of outputs, leading to outcomes and in turn to impacts.
- An **output** is the immediate, visible, concrete and tangible consequence of program/projects inputs.
- **Outcomes** constitute the short-term effect of the program/project. This is generally the level where the beneficiaries or end users take ownership of the program/project and CIDA funding comes to an end.
- Finally, the **impact** is the broader, higher-level, long-term effect linked to goal or vision.

This set of basic definitions, the policy statement, and the key principles together form the foundation for the systematic implementation of the RBM Policy.

29.97 To make the Policy operational, an RBM training and skills development program for CIDA staff will be launched in the Fall of 1996, operational guidelines

will be developed, and a workplan on the design of a databank on performance information is now under way. The databank will record and present performance information for managers at all levels as a support to decision making and reporting. In addition, a joint task force on results-based contracting, with members from CIDA and the supplier community, has produced a report outlining the major issues and concerns surrounding this complex initiative.

29.98 More significant, the program branches are introducing results-based management concepts in their day-to-day work. For example, in order to develop a common understanding of the application of the RBM Policy and the Agency's progress in implementing it, seminars have been held in the field and at headquarters, attended by CIDA staff and its partners. Work is progressing on the development and use of a revised Logical Framework Analysis (LFA), a key tool for project design and monitoring, to introduce a more rigorous results focus to project design and monitoring.

29.99 Performance indicators are an important part of results-based management. CIDA is devoting considerable time and effort to developing appropriate performance indicators. CIDA's Policy Branch has prepared guides and a training program for the use of gender indicators. A new guide for developing and selecting performance indicators has also been prepared by the Asia Branch to assist in project design, implementation and monitoring. This new guide facilitates coherence between indicators at the project and higher levels.

29.100 CIDA has taken steps to systematically collect consistent information about its results. The program branches now report annually on their results achievements according to CIDA's

six priorities. Vice-Presidents review the progress toward results in projects in their respective branches. This information is shared with the Executive Committee at its regular autumn corporate planning and review meetings. A similar exercise in progress for this year has incorporated the concept of the results chain stated in the RBM Policy.

Improved Reporting and Transparency

29.101 *Canada in the World* committed CIDA to improved reporting of the results of its development efforts to Parliament and the public. This was to be achieved, in part, by making the Main Estimates a key reporting tool for the Agency. Over the past year, CIDA has made changes in this document's structure so that it is a clearer and simpler presentation of information. CIDA's section of the 1996-1997 Main Estimates reports on disbursements and results across all programming channels according to the six ODA priorities. This document also provides specific examples of CIDA activities and results in the priority areas.

Simplicity

Keep it easy to understand and apply.

Learning by Doing

Implement iteratively, refine as we learn.

Broad Application

Use results-based management in all projects and programs, where feasible.

Partnership

Collaborate and foster common understanding with partners.

Accountability

Accept accountability (by individuals) for delivering results.

Transparency

Promote better reporting on development results.

The program branches are introducing results-based management concepts in their day-to-day work.

CIDA has taken steps to systematically collect consistent information about its results.

Exhibit 29.8

Key Principles of CIDA's Results-Based Management Policy

The System has two main components: a Framework of Results and Key Success Factors for assessing projects and a set of Assessment Tools.

It is important to ask the right questions and look for both qualitative and quantitative data to answer them.

29.102 CIDA is committed to undertaking a series of six major performance reviews, one for each of the programming priorities identified in the government's foreign policy statement, *Canada in the World*. These reviews will cover a broad range of Agency activity, and constitute a structured framework for learning from experience. The reviews will be completed in the following sequence: Women in Development and Gender Equity (1996); Basic Human Needs, including Food Aid and Infrastructure Services (1997); Private Sector Development and Environment (1998); Human Rights, Democratic Development, and Good Governance (1999).

29.103 The Agency now uses additional vehicles for reporting information on CIDA initiatives to parliamentarians and the Canadian public. A notable example is *Developments*, a monthly fax newsletter for parliamentarians featuring development issues and CIDA's activities and achievements. The newsletter has elicited positive feedback from some members of Parliament.

29.104 In addition, CIDA's Development Information Program has worked in partnership with non-governmental and private sector organizations to provide Canadians with information on development issues. The emphasis is on the important role and unique contributions Canadians make in developing countries.

Performance Measurement Systems

29.105 An important element in the Agency's effort to become more results-oriented is its focus on improving its performance measurement systems. The objective of these systems is not to

measure for measurement's sake, but to provide CIDA's managers and partners with better information to manage their projects.

29.106 The uniqueness of CIDA's various programming channels — including Bilateral, Multilateral, Canadian Partnership, and Central and Eastern European Branches — means that developing a single, standardized performance measurement system may not be feasible. Consideration must also be given to the diversity of CIDA's partners and developing countries themselves.

29.107 In view of these considerations, CIDA needs to tailor separate performance measurement systems for each of Bilateral, Multilateral, Canadian Partnership, and Central and Eastern European Branches to meet their diverse needs. CIDA also needs to look at program- and Agency-level performance measurement issues to ascertain whether it is possible to "add up" project results to comment on CIDA's performance in general or in a specific country. This year, the focus has been on developing a Bilateral Project Performance Review System since projects are the basic units of bilateral aid delivery. Projects, which have defined budgets and focus on specific objectives, constitute the discrete building blocks of the country and regional programs that help the Agency address its mandate. Lessons from developing the Bilateral System will be helpful in building performance measurement systems for the other branches.

29.108 The dynamic nature of the development process means that it is important to build a measurement system that can and will change as new knowledge becomes available and new priorities emerge. It is important to ask the

right questions and look for both qualitative and quantitative data to answer them.

The Bilateral Project Performance Review System

29.109 The Bilateral Project Performance Review System (the System) helps to standardize and integrate work already under way in the branches for measuring project performance. The System replaces what was previously referred to as the Bilateral Performance Measurement Model in the 1995 self-assessment report. The purpose of the System is to assist CIDA managers and staff in bilateral branches to manage for results, learn from experience, and report on achievements.

29.110 The System has two main components:

- a Framework of Results and Key Success Factors (the Framework) that establishes a set of information requirements for assessing project performance (Exhibit 29.9). The concentration this year has been on constructing this framework;
- a set of Assessment Tools (the Tools) that enables CIDA and its partners to satisfy the information requirements of the Framework and contribute toward improved management effectiveness.

29.111 The Framework is the core of the System. It is the first step required to develop and operationalize a functioning bilateral performance review system. It sets out the key success factors for CIDA's bilateral projects. There are three major sections in the Framework, namely: Results, Development Factors and Management Factors. The Results section is where the empirical analysis is set out — in effect, what happened. Development and Management Factors are both criteria

for success and help CIDA understand why things happened (or did not happen).

- The Results section helps to assess progress toward results at the three levels identified in CIDA's RBM policy: output, outcome and impact. Results will be reported for projects and for CIDA's six priorities as stated in *Canada in the World*.

- The Development Factors are relevance, appropriateness, cost effectiveness and sustainability. These factors help to clarify the notion of development effectiveness and put in perspective the difference that the project has made in the lives of the intended beneficiaries. An assessment of whether or not a project is successful is based not only on the results produced in relation to what was intended, but also on whether those results addressed important needs of the people CIDA was trying to help, whether this was done at a reasonable cost, and whether the benefits are likely to continue after CIDA funding stops.

- The Management Factors — partnership, innovation and creativity, appropriate human resource utilization, prudence and probity, and informed and timely action — are more process-oriented. These factors are key elements of successful project delivery and management.

29.112 The Tools help us to collect information based on the Framework. They will include self-assessment tools for use by managers, such as: project closing reports and guidelines for monitoring, and traditional examinations such as project evaluation, impact assessment, and, where applicable, audits. These tools will help CIDA's program and project managers to make more informed decisions. They will also help independent evaluators and auditors to form structured judgments based on comparative analysis of a consistent, organized body of information about projects.

The Development Factors are relevance, appropriateness, cost effectiveness and sustainability.

The Framework is the core of the System.

Exhibit 29.9

Framework of Results and Key Success Factors

A. Results

Achievement of Results. What progress is being made toward achievement of results at the output, outcome and impact levels?

- Actual vs. intended results in the partner country
- Actual vs. intended benefits to Canada
- Unintended results

B. Development Factors

Relevance. Does the project make sense in terms of the conditions, needs or problems to which it is intended to respond?

- Consistency with needs and priorities of targeted beneficiaries/country/region based on a sound understanding of the local context
- Consistency with CIDA policy, priorities and programs
- Consistency with Canadian foreign policy, including potential benefits to Canada
- Consistency with the efforts of local organizations and other donors addressing the same needs or problems

Appropriateness. Are the project resources, capacities and selected strategies sensible and sufficient to achieve intended results?

- Stakeholder satisfaction with and commitment to intended results and methods chosen to achieve them
- Canada's capacity to provide goods and services required to achieve intended results
- Resources and services designed and delivered in a manner that effectively responds to conditions (including risks), needs or problems identified
- Application of lessons from development experience

Cost Effectiveness. Is the relationship between costs and results reasonable?

- Comparison of costs with relevant benchmarks, where feasible, taking into consideration results achieved
- Actual expenditures correspond to planned expenditures or significant variances fully justified

Sustainability. Will project benefits continue after completion of project activities?

- Stakeholders take charge of project activities
- Commitment of sufficient financial resources to maintain project benefits, where applicable
- Adequate institutional capacity and ongoing relevance to maintain project benefits
- National and international environment conducive to maintenance of project benefits

C. Management Factors

Partnership. Is there shared responsibility and accountability for project results?

- Active participation of recipients and beneficiaries in project design, implementation and monitoring/evaluation
- Clear definition, understanding and acceptance of roles and responsibilities of project participants
- Partners in management have the appropriate authority and tools they need to make decisions and take action

Innovation and Creativity. Does the project explore new ideas and approaches to achieve its results?

- Experiment with new project design and procedures
- Calculated risk taking to achieve results
- New partnerships to achieve results
- Lessons learned from innovations recorded, reported and disseminated

Appropriate Human Resource Utilization. Are suitable human resources involved and used well?

- Good match between project needs and knowledge, expertise and personal skills of all major project participants
- Adequate management of project personnel

Prudence and Probity. Is financial information complete, accurate and reliable? Are financial resources being used economically?

- Sound financial management policies and procedures, including budgeting, accounting and reporting systems and practices
- Adequate strategies and practices respond to the nature and level of risk to project funds and assets
- Contracting and contract management in accordance with sound contracting policies and practices

Informed and Timely Action. Do we anticipate and respond to change based on adequate information?

- Effective networks and processes to identify and assess important trends and events in the project environment
- Effective monitoring and reporting systems
- Appropriate and timely response to opportunities and problems

29.113 The finalized Framework has been approved for implementation. Exhibit 29.10 lists the projects that we used for pilot-testing the Framework. Exhibits 29.11 – 29.15 illustrate the application of different factors in the Framework to some of these projects. CIDA learns from what works and what does not. In developing these applications, the emphasis was on illustrating what works and why. In the following section, we describe the process by which the Framework was developed.

Development of the Framework

29.114 The Framework was developed in three stages:

- **Stage I.** Development of prototype Framework;
- **Stage II.** Pilot-testing the prototype Framework;
- **Stage III.** Finalizing the Framework.

Peru

Peru-Canada Fund – a development institution created to deliver small-scale, grass-roots projects with vulnerable populations across Peru.

WUSC Water and Sanitation Phases I and II – implemented by the non-governmental organization World University Service of Canada to establish community-based water and sanitation systems in rural and peri-urban areas.

Bolivia

Bolivia Oil and Gas Project – an operational technical assistance project implemented by Petro-Canada International Management Services to assist the Bolivian government in reforming its hydrocarbon sector.

Egypt

Women's Initiative Fund – an operational project implemented by the Foundation for International Training that assists poor rural women in accessing credit to establish small enterprises.

Egyptian Labour Adjustment Service Phase I – implemented by Employment and Immigration Canada to assist workers displaced by public sector restructuring.

Egyptian Electrical Authority Training Project – an operational capacity-building project implemented by Ontario Hydro to develop and implement a transmission training system for the Egyptian Electrical Authority.

Philippines

Non-Formal Education Project – implemented by the Association of Community Colleges of Canada to assist the Association of Non-Traditional Education of the Philippines to become a strong self-supporting organization and provide non-formal education through its members.

Philippines Co-operatives Development Assistance Project – implemented by the Canadian Co-operative Association to strengthen the capability of co-operatives in the Philippines to serve the credit needs of the poor.

Environmental Resources Management Project – implemented by Dalhousie University to strengthen the capacity of the University of the Philippines (Los Baños) to contribute to environment and resources management practices and policy in the Philippines.

Exhibit 29.10

Projects Used for Pilot-Testing of the Framework

Consultations within the Agency helped to ensure that the Framework made sense, was practical, and met the needs of the Agency.

Stage I: Prototype Framework

29.115 In 1995, we developed a prototype Framework through consultations and a literature review.

29.116 Consultations within the Agency helped to ensure that the Framework made sense, was practical, and met the needs of the Agency. The groups consulted included senior management as well as program and project managers.

29.117 CIDA also benefited from the experience of other donors and government departments in developing and implementing performance measurement systems. Among the donors

we consulted were: United States Agency for International Development (USAID); United Nations International Children's Emergency Fund (UNICEF); United Nations Development Program (UNDP); World Bank; Inter-American Development Bank (IADB); and the Australian Agency for International Development (AusAID). Like CIDA, all of these donors are tackling new approaches to performance measurement and evaluation in response to increasing demands for demonstration of results.

29.118 Finally, the Framework benefited from consultations with Canadian development and evaluation experts,

Exhibit 29.11

Using the Framework: Results

Results

Achievement of Results: What progress is being made toward achievement of results at the output, outcome and impact levels?

Case Study: Oil and Gas Project, Bolivia

The oil and gas sector is critical to the Bolivian economy, supplying almost half of Treasury revenues. When the Government of Bolivia announced its plans in 1993 to restructure the sector as part of a broader plan of public sector renewal, privatization, and regulatory overhaul, Petro-Canada and CIDA were well-placed to assist in this exercise, having worked with Bolivia since 1989 to modernize its public oil and gas industry through the Bolivia Oil and Gas Project.

CIDA, Petro-Canada, and the Government of Bolivia have worked together in a two-pronged effort to improve the contribution of the hydrocarbon sector to the national economy. Petro-Canada, CIDA's executing agency, has provided assistance to the national oil company in its bid to improve efficiency, establish proven oil and gas reserves, and upgrade technical capacity. Petro-Canada has also provided high-level technical assistance to the National Secretary of Energy in drafting a new Hydrocarbon Law and the supporting regulations that will govern a modernized hydrocarbon sector.

Outputs level results for Partner Country achieved as planned:

- new Hydrocarbon Law drafted;
- 30 other regulations to make oil and gas sector more open to investment;
- national petroleum database established and functioning;
- new work methods and technical improvements introduced in state oil and gas company operations.

Outcomes included:

- new Hydrocarbon Law passed by Congress, May 1996;
- in 1995, increased proven reserves of gas and liquids by 13.3 percent;
- over US \$10 million in efficiency savings for state oil and gas company.

Canadian benefits realized as expected:

- 22 Canadian firms received spin-off benefits from the Bolivian Oil and Gas Project;
- approximately \$20 million in related commercial spin-offs in South America for Canadian firms since April 1995 (spin-offs also related to CIDA's Line-of-Credit Project).

Treasury Board Secretariat and other federal departments. A co-operative working relationship was established with staff from the Auditor General's Office. The inputs from these Canadian sources proved useful in comparing the Framework with practices across the federal government.

29.119 These consultations emphasized that for measurement systems to work, they need to be simple, practical and useful to program and project managers. The importance of pilot-testing and experimentation in the field was highlighted as a means of ensuring practicality and gaining the views of beneficiaries, CIDA field staff, and partners. Accordingly, CIDA developed a prototype Framework ready to be pilot-tested against actual CIDA projects.

Stage II: Pilot-Testing the Framework

29.120 The objective of pilot-testing the Framework was to ensure that it was practical and to obtain additional suggestions for improving it. The Framework was pilot-tested on nine projects in four countries (see Exhibit 29.10) in late 1995 and early 1996. The sample included:

- completed and operational projects;
- large and small projects;
- projects addressing CIDA's different programming priorities (Basic Human Needs, Private Sector Development, Women in Development/Gender Equity, and Environment);
- "soft" projects including institution and capacity building; and

These consultations emphasized that for measurement systems to work, they need to be simple, practical and useful to program and project managers.

Key Success Factors

Development Factor – Appropriateness: Are the project resources, capacities, and selected strategies sensible and sufficient to achieve intended results?

Management Factor – Timely Corrective Action: Do we anticipate and respond to change based on adequate information?

Case Study: Women's Initiative Fund, Egypt

Initially, the WIF project was designed to provide loans directly to women to carry out small-scale economic activities. However, this approach met with only limited success. Through regular monitoring the local office of the Canadian executing agency, the Foundation for International Training, was able to identify the problem and adjust the project to make it more appropriate: the project was refitted as a loan program directed to families, rather than explicitly to women.

By engaging the family in the process, the project's development of women's entrepreneurial skills and business activities received full family support. This contributed to a greater improvement in women's lives and the overall results of the project. For example, credit received through the project by female entrepreneurs and their families created 101 new businesses. We commissioned a survey of 27 of these businesses and found that they generated 151 jobs, of which 105 were for low-income women.

This case study demonstrates not only the importance of ensuring that development projects are appropriate in all ways to the local context, but that we cannot anticipate every eventuality at the design stage; therefore projects must be managed and monitored carefully, and timely action must be taken where necessary to adjust projects to improve their likelihood of achieving results.

Exhibit 29.12

**Using the Framework:
Appropriateness and Timely
Corrective Action**

- projects implemented by different partners, including Canadian non-governmental organizations (NGOs), Canadian firms, local organizations in the partner country, and a federal government department.

29.121 This cross-section of projects increased our confidence that the concepts in the prototype Framework are applicable to bilateral projects in general.

29.122 Document review and interviews with Canadian project team members were conducted at CIDA headquarters, followed by missions to the four selected countries. A representative from the Office of the Auditor General (OAG) accompanied each of the field missions. Evaluators from the International Development Research Centre (IDRC) were involved in testing two projects in Egypt. Local experts participated in the Egypt and Philippines field work.

29.123 The missions provided an opportunity to obtain the views of the

major stakeholders in these projects, particularly the beneficiaries and the recipient country partners. The Framework was discussed with CIDA's field staff, including the Heads of Aid at the Missions, and Canadian Ambassadors.

29.124 The pilot-testing resulted in a simplified Framework of Results and Key Success Factors. It also underlined the importance of developing a system for bilateral project performance review. Other lessons were that the Framework:

- has to minimize additional work for project managers;
- has to be flexible and responsive to the project context; and
- must be integrated with CIDA's planning and management processes.

Stage III: Finalizing the Framework

29.125 In the spring of 1996, the revised Framework was presented to an international workshop for input. This workshop was an innovative exercise that

Exhibit 29.13

Using the Framework: Results and Cost Effectiveness

Key Success Factor
Development Factor – Cost Effectiveness: Is the relationship between costs and results reasonable?
Case Study: Peru-Canada Fund
<p>The six-year-old Peru-Canada Fund has helped over one million Peruvians while generating \$57 million for Canadian companies. The Fund works like this:</p> <ul style="list-style-type: none"> • CIDA provides funds to a Peruvian company to buy Canadian equipment that the company needs, usually in the mining, oil and gas, and telecommunications sectors. This provides Canadian companies an entry into a new export market. • The Peruvian buyer "pays" for the equipment in local currency to the Peru-Canada Fund, a private foundation whose board is chaired by Canada's Ambassador to Peru. • The Fund uses the local currency to support grass-roots, self-help development projects, such as village water pumps, poultry-breeding facilities, and irrigation canals. The results are clean drinking water, health care, more productive farming, and financing for small businesses in isolated rural communities and the shantytowns of Lima. <p>From the standpoint of development, this funding mechanism is an efficient method of delivering Canadian development assistance to the poor. For example, from 1988–1993, the total operating costs in Canada and Peru, roughly \$5.3 million, were virtually balanced out by interest gained on the fund deposits (\$4.1 million). This 3.1 percent overhead cost on CIDA's contribution means that of every \$1.00 that CIDA provides to the Peru-Canada Fund, \$0.97 winds up in grass-roots work with the poor.</p>

brought together evaluation and audit experts with line managers to discuss development and management issues related to performance measurement.

29.126 CIDA, IDRC and the OAG co-sponsored the workshop, which was attended by over 30 participants, including the Auditor General of Canada and the Presidents of CIDA and IDRC. Representatives from USAID, the National Audit Office of the U.K., the World Bank, IDRC and the IADB presented their experience with performance measurement systems and discussed CIDA's efforts in this direction.

29.127 The international workshop yielded a number of insights into performance measurement. Based on these, CIDA concluded that:

- CIDA is one of the donors developing a performance measurement system. CIDA's framework of key factors for development and management success provides a consistent basis for the development of such a system.
- The factors in CIDA's Framework are appropriate.
- CIDA should implement the system without delay.
- A participatory process genuinely involving partners — including the recipient partners, beneficiaries and contractors — is crucial for both design and implementation of performance measurement systems.
- The Bilateral Project Performance Review System should have both independent evaluation and self-assessment by line managers as components.

The factors in CIDA's Framework are appropriate.

The international workshop yielded a number of insights into performance measurement.

Key Success Factor

Development Factor – Sustainability: Will project benefits continue after completion of project activities?

Case Study: Philippines Co-operative Development Assistance Program

In the Philippines, the not-for-profit sector is a major player in the delivery of social services and small-scale credit to the poor majority of the population. This project helped to strengthen the capacity of one of the major institutions in this sector, the National Confederation of Co-operatives (NATCCO), to deliver services to its members over the long term.

From our pilot test, we found that this project has attained its planned results at all levels, and that these are the types of results that will produce benefits that are sustainable over the long term. For example:

- A 10 million peso Central Loan Fund and a 7 million peso total asset base for primary co-ops indicate financial capacity; 273 percent increase in individual co-operative memberships and a 240 percent increase in NATCCO co-operative memberships indicate ownership and commitment.
- 45,000 co-operative members trained and 2,500 audits conducted for primary co-operatives are indicative of a strengthened capacity to carry on.

The project also enhanced NATCCO's ability to provide sustainable services to its member organizations. It had important effects on the Regional Development Centres in terms of their financial health, maturity, size, and scope and helped to increase the demands of primary co-operatives on NATCCO and its Regional Development Centres. Finally, NATCCO continues to play a leading role in the co-operative sector in the Philippines today and its reputation and credibility with the Philippines government and the larger co-operative community are firm.

This case study demonstrates how "softer" interventions such as institutional strengthening can build local capacity to deliver developmental benefits that will continue after the completion of project activities.

Exhibit 29.14

Using the Framework:
Sustainability


- Both qualitative and quantitative measures are important, including the informed judgment of CIDA staff.
 - Any system for performance measurement must recognize the value of risk taking and innovation and experimentation in aid delivery.
 - The Framework must be simple and consistent, yet flexible enough to accommodate different types of projects.
- 29.128** This international workshop contributed to the design of the Framework of Results and Key Success Factors shown in Exhibit 29.9.

Exhibit 29.15

Using the Framework:
Partnership

Illustration: WUSC staff worked with communities in coastal Peru's Rio Ingenio watershed to improve basic sanitation. In the foreground, we see some recently constructed latrines. In the background are livestock compounds relocated from the village to its perimeter. Community groups also installed their own gravity-fed potable water supply systems, with WUSC's technical assistance and training.

*Photograph by:
Stephen Potter/CIDA*

Key Success Factor
Management Factor – Partnership: Is there shared responsibility and accountability for project results?
Case Study: WUSC Water and Sanitation Project, Peru
<p>CIDA and WUSC have worked together for the current second phase of this bilateral project to develop an innovative results-based monitoring system, involving explicitly defined expected results, indicators and targets, and a regular, focussed reporting system.</p> <p>In Peru, WUSC staff have worked together with their various partners at the municipal and community levels to develop new water and sanitation systems. WUSC's comparative success has stemmed not so much from the technical quality of its work (which is high), but from its ability to “catalyze” communities to organize their commitment to self-development, a commitment that is demonstrated through voluntary contributions of family labour and new levels of co-operation both within and between communities.</p> <p>This case study illustrates the commitment of CIDA to sponsoring and demonstrating a partner rather than “patron” approach to the delivery of Canadian development assistance. Partnership established through participation, responsibility, and shared authority helps to build ownership and ensure the sustainability of results.</p>


Application of the Framework

29.129 The three stages in the development of the Framework have demonstrated that it can be usefully applied to CIDA bilateral projects. The Framework provides a standardized approach to monitoring, measuring and reporting on the performance of these projects.

29.130 In CIDA's opinion, the finalized Framework is conceptually clear, simple and easy to understand, and broadly applicable to different types of projects. The Framework captures the essential information needed for performance assessment and results-based management and could be used to report on CIDA's priorities. For example, the pilot tests indicated that the objectives of the Philippines Co-operative Assistance Development Program (Exhibit 29.14) were consistent with the strategy of the Philippines program to strengthen private and public organizations to enable the poor to gain access to assets and services, and with CIDA's poverty reduction and women in development and gender equity priorities; and the objectives of the WUSC Water and Sanitation Project in Peru (Exhibit 29.15) are consistent with the basic human need objective of the Peruvian program and the same priority of the Agency. Finally, the pilot tests demonstrated that the information requirements of the Framework are reasonable based on input from the field mission teams and program staff.

Current Status of the Bilateral Project Performance Review System

29.131 Paragraphs 29.132 – 29.139 indicate our plan for implementing the

Bilateral Project Performance Review System. CIDA has already started a process to internalize (that is, operationalize) results-based management and the Bilateral Project Performance Review System. CIDA's senior management recognizes the need for constant reinforcement of these new approaches throughout the Agency. CIDA recognizes that it will take time and commitment to internalize these, and that cultural changes will be needed to facilitate the process. CIDA is realistic about the speed at which the changes can take place. The implementation plan is based on the premise that CIDA needs to learn by doing as it integrates the system into its everyday work. The Agency will review progress after one year.

29.132 The Framework of Results and Key Success Factors will serve as the basis for project evaluations, project completion reports, and audits where applicable. It will also serve as the guide for the monitoring of ongoing projects.

29.133 The Framework will also be included in the Bilateral Road Map — an on-line guidebook that CIDA officers use when designing and managing projects. This will help ensure that the success factors such as sustainability and partnership are used consistently through all phases of the project cycle.

29.134 The application of the Framework will distinguish between new and old projects. For new projects — projects initiated after the adoption of the Framework — all elements of the Framework will be applied. Not all factors outlined in the Framework may apply to the old projects, which will be assessed on the basis of their original intent and design.

29.135 The use of the Framework will also be based on the nature of the project. For example, high-risk and innovative

The Framework captures the essential information needed for performance assessment.

CIDA's senior management recognizes the need for constant reinforcement of these new approaches throughout the Agency.

Use of judgment in adopting the Framework is a key ingredient in its successful application.

CIDA will continue to innovate and adjust as it implements the Framework and builds the Assessment Tools.

projects may call for a more complete application than lower-risk or older-type projects. A risk-based approach to extent, timing, and nature of measurement can be adopted to decide how the Framework is to be applied. Finally, not all factors listed in the Framework may be equally relevant at all points in the project cycle — design, implementation and end-of-project. Use of judgment in adopting the Framework is a key ingredient in its successful application.

29.136 Over the next year, the Framework will be used by the Performance Review Division at CIDA as the basis for project evaluations within the Basic Human Needs (including food aid), and Infrastructure Services performance reviews. It will also be used for management-requested evaluations and, where applicable, considered in management and value-for-money audits.

29.137 A prototype Project Closing Report, which translates the Framework into a standardized on-line reporting tool, has been designed and developed. This tool is currently being tested on 12 bilateral projects. Canadian executing

agents are participating in 4 of the 12 tests.

29.138 A workplan is being developed for a performance information databank that will provide CIDA project staff with on-line access to assessment tools and performance information.

Conclusions

29.139 The Bilateral Project Performance Review System represents a significant first step toward promoting more effective results-based management at CIDA. It will enhance CIDA's ability to achieve its goal of improving development effectiveness and promoting sustainable development in developing countries.

29.140 CIDA will continue to innovate and adjust as it implements the Framework and builds the Assessment Tools. Maintaining simplicity will continue to be the major emphasis. These improvements will be achieved by working together with partners in Canada and overseas.

Canadian International Development Agency

Follow-up of the Auditor General's 1994 Report on
Technical Assistance Contributions to Central and
Eastern Europe and the Former Soviet Union

Part II: Follow-up of the Auditor General's 1994 Report, Chapter 21: Technical Assistance Contributions to Central and Eastern Europe and the Former Soviet Union

Assistant Auditor General: David Ratray
Responsible Auditor: Vinod Sahgal

Background

29.141 The goal of our 1994 audit was to provide objective information that would help Parliament scrutinize Foreign Affairs' use of resources and its management to achieve results. In addition, we wanted to highlight areas where improvements were possible in both program and project management. That audit indicated that Foreign Affairs had started to make a substantive attempt to assess program management and to take significant steps to make it more results-oriented. We pointed out that several challenges and concerns remained regarding Foreign Affairs' ability to assess the effectiveness of the program in such a complex environment.

29.142 In April 1995, the government transferred the management of the program from Foreign Affairs and International Trade Canada to the Canadian International Development Agency (CIDA). This follow-up reports on the progress made on each of the issues we raised in 1994.

29.143 Objectives and authority. The program of assistance to Central and Eastern Europe (CEE) and the Former Soviet Union (FSU) began in 1989 in response to the end of the Cold War. The government wanted to establish quickly Canada's presence in the region. It was successful in this effort. The government,

in its 1995 foreign policy statement *Canada in the World*, set out its support of the reform process in CEE/FSU, which it links to Canadian security and economic interests. Drawing from the government's foreign policy vision for the CEE/FSU region, the program's objectives continue to be to increase Canadian trade and investment links with the region, to support transition to market-based economies and to support democratic development. There is now added emphasis on the latter objective.

29.144 Although the program does not fall within the ambit of Canada's Official Development Assistance (ODA), CIDA points out that its programming is consistent with the six ODA priorities. Program funding is now approved under the International Assistance Envelope with the rest of CIDA through Main Estimates (Vote 15 and Vote 10) and is no longer done on an annual basis by Treasury Board. There is no specific enabling legislation for the program.

29.145 A significant proportion of bilateral disbursements has gone to a few countries, such as Russia (Exhibit 29.16). Although the program covers 26 countries in the region, specific strategic programming is done for only the key countries (Russia, Ukraine, Poland, the Czech Republic, Hungary, Romania, Slovakia, the Baltic States). The region continues to change rapidly. The Czech

The program's objectives are to support transition to market-based economies, to support democratic development and to increase trade and investment links with the region.

A significant proportion of Canadian bilateral technical assistance has gone to a few countries, such as Russia.

Program management moved to CIDA in 1995. Foreign Affairs retained responsibility for policy formulation.

Republic, Hungary, Poland (the "Visegrad Three") and the Baltic States have moved into a period of growth. By the end of 1996, the Visegrad Three will all be members of the Organization for Economic Co-operation and Development (OECD), a reflection of the success of their reform initiatives. CIDA points out that although Russia initially embarked enthusiastically on economic reform, the social and human costs have been high, leading to popular disenchantment and some official retrenchment. Ukraine, initially reluctant to introduce reform, has been moving ahead in certain areas, especially in the energy sector, but lagging in others, notably in agriculture. With the signing of the Dayton Accords in December 1995, the program's activities in the former Yugoslavia have expanded to include post-conflict rehabilitation, reconstruction and democratic

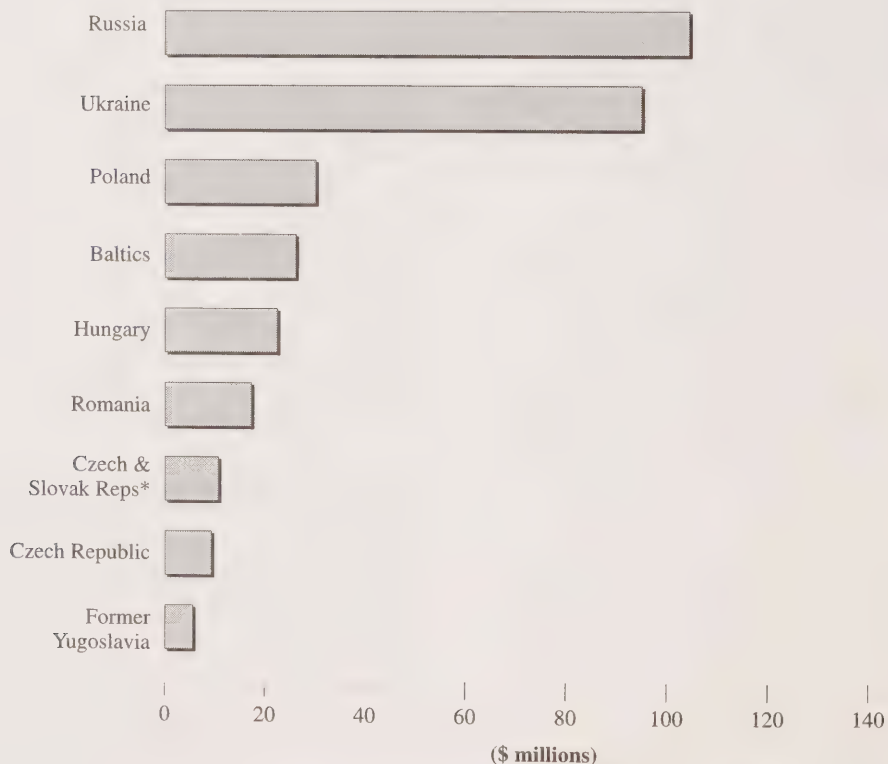
development as well as humanitarian relief.

29.146 Transfer from Foreign Affairs to CIDA. Although overall policy direction remains with Foreign Affairs to ensure consistency between assistance policy and activities and Canada's foreign policy objectives and operations in the region, CIDA is now the agency responsible for managing the program.

29.147 CIDA's view is that consolidation of all Canadian aid activities in one agency has allowed resources and CIDA's extensive range of technical and managerial experience to be made available to the program more easily, both at headquarters and in the field. However, CIDA also brought to our attention that program management was disrupted, causing delays in addressing some of the issues raised in our 1994 Report. As well,

Exhibit 29.16

Disbursements of Canadian Bilateral Technical Assistance to Key Countries, 1989-90 to 1995-96



* Disbursements before separation of Czech and Slovak Republics

day-to-day contact with Foreign Affairs staff was reduced and considerable time had to be invested in integrating with CIDA's financial and personnel systems and administrative procedures.

Conclusion

29.148 There is progress on several fronts but the need to strengthen procedures for measuring and reporting on program effectiveness requires attention.

29.149 The program has become more results-oriented. What is needed now is to build on the progress made to date. This can be accomplished by:

- implementing the country program strategies recently developed;
- continuing to focus attention on selecting high-quality projects and partners;
- encouraging and rewarding experimentation, innovation and adaptation; and
- reporting on results and accomplishments of its projects and programs in terms of their contribution to Canada's program strategies and objectives.

29.150 In 1994, we reported that there was an opportunity to improve the quality of information provided to Parliament on the results of the program. As a first step, CIDA could provide to its Minister and Parliament reports on its accomplishments in countries such as Poland, Hungary and the Czech Republic. In these countries, Canadian assistance efforts started seven years ago and are now likely to be wound down. In addition, parliamentarians would be interested in getting information on the potential for results in countries like Russia where the bulk of funding is now going.

29.151 The Agency states that it will take three to four more years before it is fully capable of reporting to Parliament on the results of the program. We urge the Agency to work toward accomplishing this objective in a shorter time.

Observations

Program Effectiveness

29.152 CIDA has developed program strategies for the key countries. In 1994, when the primary emphasis was on the transition to market-based economies and on increasing Canadian trade and investment links with the region, we raised the issue of whether and to what extent participation in technical assistance projects had resulted in commercial benefits, such as incremental sales of goods and services, to Canadian firms. We believed that the important question facing Foreign Affairs at that time was whether its approach to consultation and planning, information gathering and dissemination, and follow-up opportunities was adequate and sufficiently strategic to derive the maximum benefit from the existing potential. The Department agreed that this question needed further examination. We observed that a more strategic focus was needed to maximize the long-term potential of trade and investment opportunities.

29.153 Since 1995, CIDA has developed a Regional Framework for the program, which defines the approach to pursuing the three major program objectives. CIDA states that the Framework is designed to provide coherence and consistency to the program. It sets out the mission and objectives; situates the region in its broad political, economic and social context; deals with Canadian interests in the region; and stresses "reform" as the

There is progress on several fronts but attention is required to strengthen procedures for measuring and reporting on program effectiveness.

CIDA needs to implement its program strategies for key countries and determine what indicators will be used to judge whether these strategies are working.

CIDA has noted an important lesson — namely, high-quality projects in the hands of qualified and committed executing agents are prerequisites for success.

CIDA has continued the improvement process started in Foreign Affairs to make project management more results-oriented.

guiding program principle and flexibility and partnership as important program characteristics. The Framework also looks back at lessons noted.

29.154 CIDA believes that the country is the appropriate level for programming; accordingly, program strategies for the key countries in the region have recently been developed. We were informed that these strategies are based on an analysis of local conditions and needs and Canadian interests. The Canadian private sector was consulted in developing the strategies. We encourage CIDA to determine what indicators will be used to judge whether its country strategies are working.

Project Management

29.155 Project management has become more results-oriented. In 1994, we reported that rapid growth in the scope and volume of technical assistance contributions, combined with shortage of staff at departmental headquarters and missions, had resulted in insufficient attention being paid to project management in the early stage of the program. Project selection criteria were unclear; monitoring was insufficient and ad hoc; and no evaluations, auditing and results measurement were undertaken during the period from inception of the program until December 1992. At that point, Foreign Affairs had initiated a number of steps to make its approach to project management more results-oriented. At the time our 1994 audit was completed, it was too early to assess the effectiveness of those steps.

29.156 The improvement process begun in Foreign Affairs has continued with the transfer of the program to CIDA. In its Regional Framework, CIDA points out that based on several internal reviews of the program and project evaluations at the policy level, and through direct field

experience gained in the last seven years, it has noted several lessons and drawn certain conclusions that can enhance the potential for results from its projects. For example, prerequisites for project success are the quality of the project selected for funding and the chosen partner's technical qualifications and commitment to give priority to building appropriate partnerships in host countries, often under difficult conditions. This is particularly important for projects pursuing the promotion of democratic development and supporting the transition to market-based economies. In addition, it is important that management support projects that encourage and reward experimentation, innovation and adaptation.

29.157 Field presence dedicated to the program has been strengthened. Project selection and approval guidelines as well as guidelines for an "Approach to Performance Review and Assessment" have been issued to staff. The latter envisage a formal review process. Project managers will be responsible for ensuring that projects under their control are appropriately monitored, and the Central and Eastern Europe (CEE) Branch will be required to conduct reviews of programs and projects and make these accessible to the public.

29.158 CIDA informed us that it is setting up a system to collect and document information on the results of projects. The objective is to learn from successes and failures and improve decision making to avoid repeating mistakes. This initiative is consistent with the effort under way across the Agency to strengthen procedures for measuring and reporting on effectiveness.

29.159 The Agency pointed out the need for additional training and coaching for its officers and the development of standard terms of reference and model reports to

assist staff in carrying out assigned monitoring functions. In this regard, we recognize that monitoring progress in areas such as democratic development will require different indicators and timeframes for the evaluation of results than those used in, for example, trade and investment initiatives. However, monitoring the progress toward results needs to remain a subject of interest throughout the project's life cycle. It would therefore be timely to accelerate the development of indicators that are simple and usable for measuring and reporting on the progress toward the program's results.

29.160 Staff stress the need for continued senior management leadership and support to oversee the implementation of the results-oriented management system. In our view, CIDA also needs to clarify the respective accountabilities of staff associated with setting up and implementing the systems and of those responsible for collecting and documenting information on the results of its programs and projects. As well, the form and content of reports that are required for senior management will need to be established. Officials indicated that two to three years will be needed before the proposed system is fully in place.

29.161 The Branch pointed out that it had experienced some difficulty with some of the independent monitors in getting a complete and true description of difficulties occurring with projects. In the Branch's view, this is one of the constraints it faces in making the reporting on the prospects of results more transparent.

Audit of Contributions

29.162 The nature and extent of assurance that money has not been

expended for purposes other than for which it was appropriated by Parliament is improving. In 1994, we pointed out that funds for the Department's technical assistance contributions program are appropriated by Parliament. As Parliament's auditor, we have a duty to report cases in which "money has been expended for purposes other than for which it was appropriated by Parliament". Foreign Affairs audits of its technical assistance program had focussed on compliance with the terms and conditions of contribution agreements, in accordance with Treasury Board guidelines on the audit of federal contributions. Our concern was with the ability of the system then in place to minimize the risk that money was spent for purposes other than those intended by Parliament. The audit opinions issued by audit firms on contract to Foreign Affairs did not refer to "the use of funds for purposes intended by Parliament". We acknowledged that the auditors had performed their work in accordance with government guidelines and standards.

29.163 At the time our 1994 audit was completed, Foreign Affairs had begun steps to make more explicit the nature and extent of assurance sought from audit.

29.164 Since the program was transferred to CIDA, the Agency has successively improved the quality of assurance it seeks from its auditors. For example, typical terms of reference for audits now require the audit firm to, among other things, identify if and where money has not been used for the purposes intended by the contribution agreement.

29.165 The Agency has also introduced guides for staff, held briefing sessions to help executing agencies and staff better understand contribution agreements and financial reporting requirements, and provided coaching to staff on contracting,

The Central and Eastern Europe Branch pointed out that it had experienced some difficulty with some of the independent monitors in getting a complete and true description of difficulties occurring with projects.

The nature and extent of assurance that money has not been expended for purposes other than for which it was appropriated by Parliament is improving.

A separate section, "Countries in Transition", in CIDA's 1996-97 Part III of the Main Estimates is an improvement; however, better information on results and accomplishments is needed.

drafting contribution agreements and financial reporting.

29.166 We examined a sample of nine audit reports conducted by two audit firms, the corresponding contribution agreements and the terms of reference given to the audit firms.

29.167 In accordance with the terms of reference, the audits conducted by the firms are compliance audits that focus primarily on an examination of evidence provided by the Canadian executing agent in support of the amounts incurred and claimed. The audit opinion rendered by the auditors, in all nine cases, was that the amounts that the auditor had been able to audit were in accordance with the terms and conditions of the contribution agreements. The auditors identified in some cases that money had been spent for purposes other than those intended in the contribution agreements. Steps were taken to recover any excess payments. However, in three cases, the auditors pointed out that they had been unable to audit significant amounts claimed by the CEAs. The total claimed amount in these three cases was \$ 2.5 million, of which the auditor was unable to audit \$ 793,596, or 31 percent of the claimed amount. In two cases (\$511,633), management decided that it was not cost-effective to pursue the matter any further. In the third case (\$281,963), the unaudited amount related to the contribution made by CIDA's partners overseas. The Branch decided that it would not pursue this case further on the grounds that it would be impracticable to do so. We were informed that the Agency's management and its internal auditors have reviewed these cases and are satisfied that staff took the appropriate course of action.

Reporting to Parliament

29.168 Better information on results and accomplishments is needed. In 1994, we examined at Foreign Affairs several departmental Part IIIs to determine how and to what extent the Department reported on the results of the program. We found considerable narrative, in a number of different sections, on the program rationale, principal recipient countries, priority sectors, types of assistance, and past, current and future activities. This kind of information provided useful background information and context. However, important information on results and accomplishments that we believe is central to high-quality stewardship reporting was missing. Public documents did not provide substantive information on the program's magnitude, its strategic objectives, its plans and the indicators to measure results, or actual results achieved.

29.169 In 1994, we suggested that Foreign Affairs could provide parliamentarians with a periodic performance-oriented report on its technical assistance program, to improve transparency in reporting and to demonstrate the value of the program and how effectively it was managed.

29.170 CIDA has improved certain aspects of the information provided to Parliament on the program. The 1996-97 Part III of CIDA's Main Estimates has for the first time a separate section on "Countries in Transition". This section provides information in one place on the program budget, objectives, number and types of projects, and total expenditures in the major countries. This reflects a change from the situation in 1994 when fragmented information on the program was found in several sections of Part III.

29.171 Program officials point out that the Central and Eastern Europe (CEE) Branch is working with the rest of the Agency to improve its capacity to report on the program as a whole; a CIDA-wide corporate planning system for tracking results achieved and for reporting is in the early stages of being developed. The program, they point out, is also in the early stages of being integrated into CIDA's corporate reporting system and it will take three or four years before the program is fully capable of reporting against a performance database. The reason provided to us is that only projects approved during 1996–97 will be tracked by the new system. The Branch believes that meaningful reporting on results and achievements in these cases is not feasible until 1998–99 or later.

29.172 We recognize that achieving and measuring the results of initiatives in the areas of promoting democratic development and supporting market-based economies, two of the program's three objectives, are more complex and difficult compared with achieving and measuring results in the areas of trade and investment. However, in our view, the Agency needs to be able to monitor and report on a periodic basis the extent to

which its projects and the program, even in the more difficult areas, are contributing toward achieving the intended results.

29.173 We believe that the CEE Branch needs to implement a more comprehensive management information system for both measuring and reporting on the results of its country programs and specific projects within each country, both internally and externally to its partners. In this regard, the Branch may benefit from the practices of other branches of CIDA and other donor agencies that have introduced procedures for measuring their contribution to the development of such countries.

29.174 We further believe that it would be highly desirable for parliamentarians to have information on the potential for results as well as actual accomplishments, specifically in Poland, Hungary and the Czech Republic, where Canadian assistance efforts started seven years ago and from which a phased exit is envisaged by 2000–2002. Similarly, it should be of interest to parliamentarians to have information on the results that the Agency is trying to accomplish in countries like Russia, where the largest sums of assistance money have been allocated.

We believe that parliamentarians would be interested in having information on accomplishments achieved in Poland, Hungary and the Czech Republic, all mature programs, and on what CIDA is trying to accomplish in Russia where the largest sums of assistance money have been allocated.

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Report of the
Auditor General
of Canada
to the House of Commons

Chapter 30
Correctional Service Canada –
Reintegration of Offenders

November 1996

**Report of the
Auditor General
of Canada
to the House of Commons**

Chapter 30
Correctional Service Canada –
Reintegration of Offenders



November 1996

This November 1996 Report comprises 19 chapters, including “Matters of Special Importance”, as well as a Foreword and the Main Points from the May, September and November 1996 Report chapters. In order to better meet clients’ needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.

Chapter 30

**Correctional Service Canada –
Reintegration of Offenders**

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants.

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Correctional Service Canada – Reintegration of Offenders

Assistant Auditor General: Maria Barrados
Responsible Auditor: David Brittain

Main Points

30.1 Correctional Service Canada has two main responsibilities — the incarceration of offenders and their safe reintegration into the community. In 1995–96, reintegration activities involving both the 8,000 offenders being supervised in the community and the 14,500 incarcerated cost nearly \$300 million. The importance of the second part of the mandate of Correctional Service, safe reintegration into the community, is shown by the fact that in the last decade over 70,000 federal offenders were released into the community. In this audit, we looked at the \$79 million spent on the Service's process for making release recommendations to the National Parole Board.

30.2 Lack of co-operation between the federal and provincial governments compromises public safety. Correctional Service has serious difficulties in getting information on offenders from official sources such as police reports, Crown counsel briefs and judges' reasons, despite a statutory requirement to do so. Numerous investigations state that a lack of critical information has been a factor in tragedies involving violent offences by released offenders. Information-sharing agreements are in place with some, but not all, provinces. Where agreements are in place, there are still difficulties with timeliness and availability.

30.3 Correctional Service does not always prepare the casework of offenders in time for their first parole eligibility date. We estimated that in 1995–96 almost no one with a short sentence of two to three years was ready for the first possible parole review. This is not the most effective long-term strategy for ensuring public safety if scarce resources are used to manage low-risk offenders when they could be used to manage higher-risk offenders.

30.4 The work environment of case management officers impairs the quality of parole recommendations. The training and caseload standards of case management officers are inadequate. Correctional officers (guards) are not fulfilling their responsibilities to provide input into the recommendation for parole. Most important, quality control for parole recommendations is not at a level commensurate with the risk the offender presents to society.

30.5 Correctional Service is not managing its reintegration activities effectively. This is the third in a series of chapters that have identified systemic weaknesses in reintegration activities in the Service. All three audits identified serious weaknesses in implementing standardized procedures, developing performance measures and establishing adequate quality control mechanisms. Although Correctional Service has identified problems with the reintegration half of its mandate, it has not been successful at resolving them. We believe that Correctional Service will need to fundamentally rethink the way it approaches the management of reintegration activities, if it is to ensure the long-term safety of the public.

Introduction

30.6 In Canada, over 70,000 federal offenders were released into the community in the last decade. The reintegration of offenders into the community is one of the most important tasks of Correctional Service Canada. Currently, 8,000 offenders are being supervised in the community. Another 14,500 offenders are incarcerated; most of them will eventually be released (see Exhibit 30.1).

30.7 In 1995–96, Correctional Service spent \$300 million on services geared to safely reintegrating offenders into society. Exhibit 30.2 shows our estimated breakdown of these expenditures by major function. Exhibit 30.3 shows the number of admissions to federal prisons. In 1995–96, 3,024 offenders were released on parole; 4,457 were released at the two-thirds point of their sentence (statutory release); and 417 were released at the end of their sentence (see Exhibit 30.4). In the same year, 483 offenders were detained in prison until the end of their sentence because they were deemed to be too dangerous for release at the two-thirds point of their sentence.

30.8 From the earliest days in Canada, changing the behaviour of offenders has been one of the goals of corrections. Before Kingston Penitentiary opened in 1835, it was thought that removing individuals from the “evil influences” that had led them to crime and subjecting them to hard work and punishment would reform them. Today, crime is seen as a threat to public safety. Correctional Service’s contribution to public safety is the management of offenders through an interventionist approach. This approach is based on assessing the risk that an offender will reoffend, and on encouraging offenders to participate in

programs designed to change attitudinal and behavioural factors, thereby reducing the likelihood that they will reoffend. This approach represents a different emphasis for an organization that has been largely preoccupied with security concerns.

The focus of the Service’s mandate is public safety

30.9 In 1992, a new Act, the *Corrections and Conditional Release Act*, was proclaimed into law. It governs all aspects of the prison and parole systems. The Act emphasizes the safe and humane custody of offenders and recognizes that the long-term protection of society is best assured through safely returning offenders to the community as law-abiding citizens (see Exhibit 30.5).

30.10 The Act provides the National Parole Board with the authority to release most offenders on full parole after they have served one third of their sentence (see Exhibit 30.6). The Parole Board can also release offenders on day parole six months before they are eligible for full parole, provided they have been incarcerated for a minimum of six months. Most offenders are entitled to be released by law on statutory release after serving two thirds of the sentence pronounced by the judge, if they have not already been paroled by the National Parole Board. A small number will be detained in prison until the end of their sentence because Correctional Service has reasonable grounds to recommend to the National Parole Board that these offenders may commit a violent offence if the final third of their sentence were served in the community.

30.11 The Act sets out levels of restricted freedom, from full incarceration through to supervision in the community, with complete freedom coming only when the sentence expires. The Act provides that offenders be considered for release on

Exhibit 30.1

Offender Population as at March 31

Offender Location	1991-92	1992-93	1993-94	1994-95	1995-96
Institution	12,719	12,877	13,971	14,539	14,449
Community	9,112*	9,328*	8,452	8,057	7,824
Total	21,831	22,205	22,423	22,596	22,273

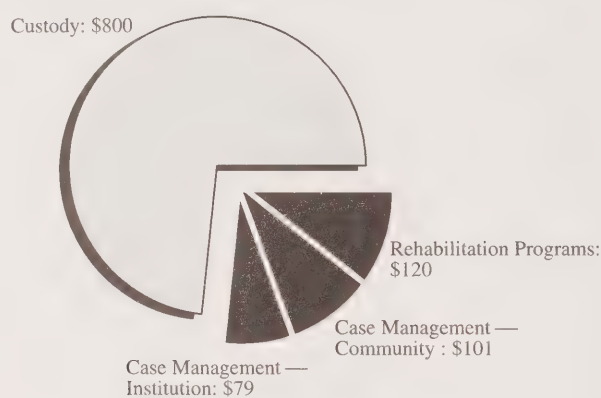
Source: Correctional Service Canada

* Total is inflated because it includes offenders deported and temporarily in custody.

Exhibit 30.2

Estimated Breakdown of 1995-96 Expenditures of Correctional Service

(\$ Millions)



Source: Office of the Auditor General

Exhibit 30.3

Admission Trends, Fiscal Years 1991-92 to 1995-96

Type of Admission	1991-92	1992-93	1993-94	1994-95	1995-96
Warrant of Committal	4,701	5,097	5,120	4,788	4,405
Revocation* without Offence	1,258	1,457	2,175	2,451	2,137
Revocation* with Offence	977	1,371	1,541	1,138	1,027
Total	6,936	7,925	8,836	8,377	7,569

Source: Correctional Service Canada

* Conditional release suspended and offender returned to federal prison.

Type of Release	1992-93	1993-94	1994-95	1995-96
Parole	4,379	4,664	3,527	3,024
Statutory Release	3,639	3,518	3,815	4,457
Warrant Expiry	569	282	370	417
Total	8,587	8,464	7,712	7,898

Exhibit 30.4

Release Trends, Fiscal Years
1992-93 to 1995-96

Source: Correctional
Service Canada

The mandate of Correctional Service is defined by the *Corrections and Conditional Release Act* (1992), which states that “the purpose of the federal correctional system is to contribute to the maintenance of a just, peaceful and safe society by:

- carrying out sentences imposed by courts through the safe and humane custody and supervision of offenders; and
- assisting the rehabilitation of offenders and their reintegration into the community as law-abiding citizens through the provision of programs in penitentiaries and in the community.”

Exhibit 30.5

The Mandate of Correctional
Service Canada

Source: *Corrections and
Conditional Release Act*

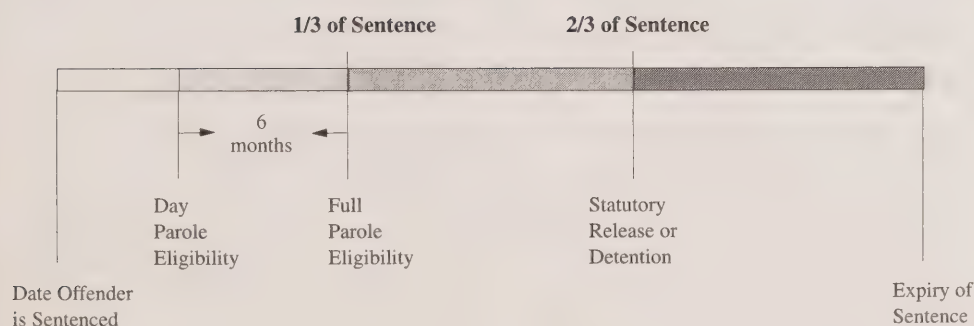


Exhibit 30.6

Milestones in the Sentence of
an Offender with a Fixed-Term
Sentence

Source: *Corrections and Conditional Release Act*

New offences committed by those on parole or statutory release meet with outrage because there is an expectation that public safety should not be compromised by offenders still serving any part of a sentence.

day parole and full parole at particular points in time and released at the two-thirds point in the sentence. In complying with the Act, the Service must manage its finite resources for incarceration and reintegration in such a way as to maximize public safety. The public's risk is increased if the finite resources for incarceration and reintegration are not used wisely. For example, if resources are used to incarcerate an offender who could be released with minimum risk, then these resources may not be available for the reintegration of more dangerous offenders.

30.12 The different stages in the release process can be illustrated by an example of an offender who has been convicted of a charge of break and enter and has been sentenced to three years. If this offender is granted day parole as soon as he becomes eligible, he will be released from custody after serving six months. If he is denied day parole, he may be released on full parole after serving 12 months. However, if he is denied parole, he will be released by law on statutory release after serving 24 months, provided he is not detained. He will then spend the remaining 12 months of his sentence in the community, provided he complies with the conditions of his community supervision program.

30.13 Correctional Service uses a case management process to manage the reintegration of offenders (see Exhibit 30.7). The process consists of a number of stages, including:

- assessing offenders when they enter federal corrections to identify the "criminogenic" factors that have led to their criminal behaviour and developing a correctional plan (see Exhibit 30.8);
- assessing whether participating in programs has contributed to reducing the risk that an offender will commit another offence after release;

- making recommendations to the National Parole Board on the suitability of an offender for release to the community;
- release by the National Parole Board on parole or release by law after serving two thirds of the sentence (statutory release); and
- providing supervision, further assessment and programs in the community until the end of the sentence.

Many different factors affect reintegration

30.14 Different perspectives are brought to bear on the management of offenders. The legal profession focusses on the accused in terms of a particular set of facts occurring at a fixed point in time. While the sentencing judge is largely concerned with the crime the offender has committed, Correctional Service and the National Parole Board have broader perspectives. They must consider the crime, the offender's entire history, his institutional behaviour, and results of rehabilitation efforts, and then try to predict what he will do in the future. This prediction is difficult to make; it is not possible to predict with scientific certainty who will reoffend and, especially, who will reoffend violently.

30.15 Public expectations affect the ability to gradually release offenders through parole and statutory release. New offences committed by those on parole or statutory release meet with outrage because there is an expectation that public safety should not be compromised by offenders still serving any part of a sentence. Exhibit 30.9 shows the number of federal offenders charged with violent offences while under supervision in the community. Expectations about the safe release of offenders are further complicated by a general misunderstanding on the public's part that a sentence always means incarceration

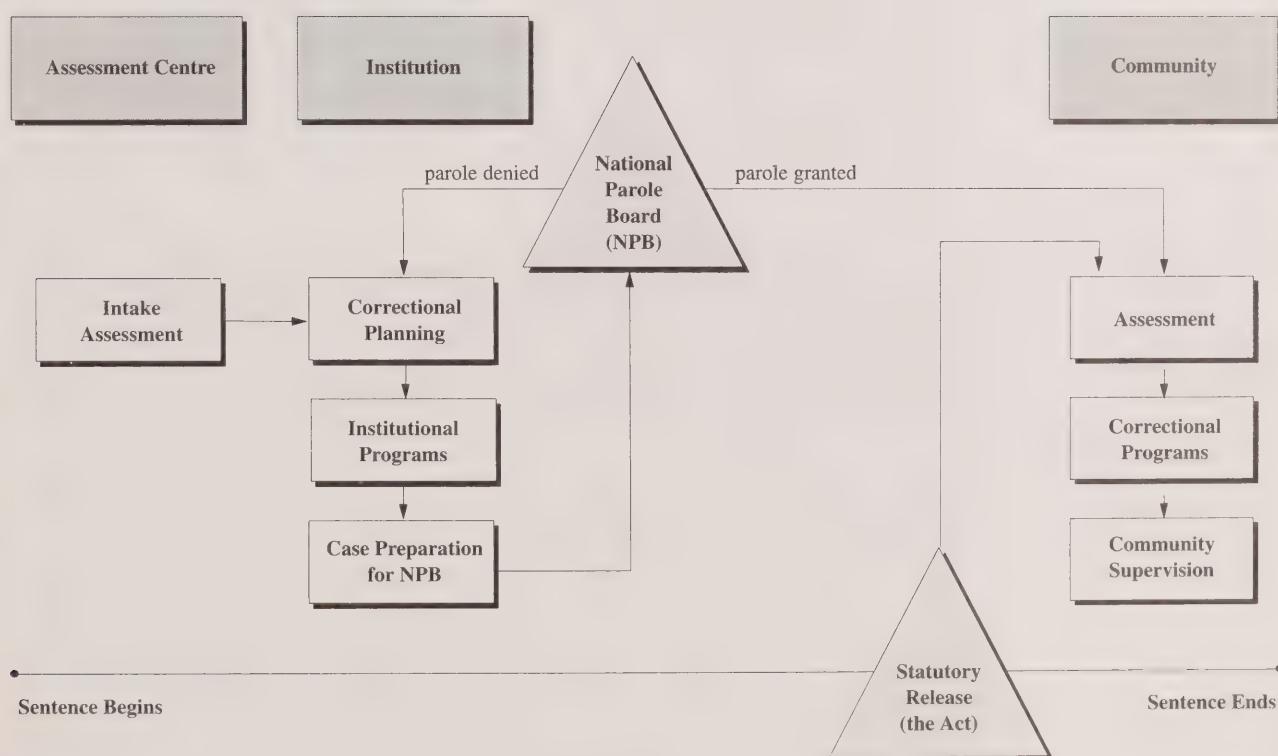
until the last day. However, a sentence of 12 years means that an offender could be released on parole after serving four years and will generally be released by law after serving eight years (that is, at the two-thirds point in the sentence). Under the Act, there is a need to balance the short-term risk to society of releasing an offender against the benefit of long-term safety using a gradual, supervised release. For example, Canada could hypothetically avoid all short-term risk to the community by detaining all offenders until the end of their sentence. However, such an approach

would affect the Act's goal of reducing risk before and after the sentence is finished. There is no difference in the impact on victims or society if an offender reoffends before his sentence has expired or after his sentence has expired.

30.16 The capacity to house offenders and offer rehabilitation programs also affects reintegration. Correctional Service has a finite capacity for housing, programming, monitoring and assessing offenders. When prisons are filled, delays may occur in assessing offenders, and

Exhibit 30.7

The Reintegration Process



Source: Office of the Auditor General

Under the Act, there is a need to balance the short-term risk to society of releasing an offender against the benefit of long-term safety using a gradual, supervised release.

there may be waiting lists for programs. All of these factors can affect the timeliness and quality of release recommendations to the National Parole Board.

30.17 Offenders can also make the task of reintegration difficult. By the time offenders have entered a federal penitentiary, many have problems that are highly resistant to change. While some offenders want to change their behaviour through programs and interactions with staff, others refuse to participate in these opportunities. They choose to simply wait out their sentence. This attitude can make Correctional Service's job more difficult.

Focus of the audit

30.18 The focus of this audit was to determine whether the institutional case management process is efficient and contributes to reintegration of offenders. Further details on the audit scope and objective are found at the end of the chapter in the section **About the Audit**.

Observations and Recommendations

Collection of Official Information, and Parole Eligibility

Lack of co-operation between the federal and provincial governments compromises public safety

30.19 By the time an offender arrives at a federal institution, much information on him exists in official documents such as court and police reports and records from other provincial agencies. The Act requires Correctional Service to gather relevant information from these sources, because it is essential to ensuring better decision making at every stage of a sentence.

30.20 Police reports, for example, may contain information on the circumstances of the crime, such as the degree of planning involved, and motivational factors, such as drugs, aggression or sexual gratification. Court documents, such as the judge's reasons for a sentence

Exhibit 30.8

Factors That Relate to Criminal Behaviour

Research indicates that various factors relate to criminal activity. A number of these factors are static and cannot be influenced (for example, age of first criminal conviction). Others, however, are dynamic, and it is these factors that the Service hopes to influence with programs. The dynamic factors include:

- **Employment.** Many offenders lack the education or job skills to be able to get or hold a job.
- **Personal/Emotional Orientation.** Many offenders have serious problems with impulsive behaviours, controlling anger and solving problems. In addition, a significant proportion of federal offenders have committed sexual offences.
- **Associates/Social Interaction.** Many offenders have friends who encourage their criminal behaviour or substance abuse habits.
- **Substance Abuse.** Many offenders have significant problems with drugs and alcohol.
- **Community Functioning.** Many offenders have difficulties in managing their finances and leisure time.
- **Marital/Family.** Many offenders lack parenting skills and have relationships marked by instability and family violence.
- **Attitude.** Many offenders maintain attitudes that are anti-social and/or anti-female.

Source: Correctional Service Canada

may indicate what steps from the Court's perspective should be taken to ensure safe reintegration. Crown briefs may indicate whether an offender's criminal charge has been plea bargained. Young offender records indicate the age of first offence — one predictor of future criminal activities. Provincial records can provide information on an offender's mental health and his behaviour in jail and while on probation.

30.21 Although this information is both relevant and available, Correctional Service has difficulties in obtaining from provinces and municipalities documents such as police reports, Crown briefs and judges' reasons for sentence. Recent Correctional Service studies show, for example, that in Ontario only 61 percent of the judges' reasons were available to the Service; in the Atlantic Region there are some problems with the availability of police reports (see Exhibit 30.10).

30.22 The problem is exacerbated because some documents are not being transferred at the appropriate time. Although these documents are always available when an offender is sentenced, Correctional Service does not receive

them at that time. By the time the Service requests the documents, Crown attorneys and court administrators have filed the offender's information used at trial and have moved on to other activities. The Service's attempts to retroactively gather the information from a variety of sources makes the task much more difficult.

30.23 Not having relevant information can have serious consequences for public safety. For example, in a National Parole Board review of 60 sensational incidents (those usually involving violent offences committed by released offenders under supervision), missing police and court information was listed, among other factors, as contributing to poor-quality release decisions in 12 of the 60 incidents (see Exhibit 30.11). We note that the Ruygrok inquiry in 1987 highlighted the need for more co-operation and information sharing between the provinces and the federal government in order to reduce the risk of violent reoffences.

30.24 When Correctional Service does not have enough information on the offender and the crime, the information used comes from the offender — who may well minimize or deny the details and circumstances of his crime. This situation

When Correctional Service does not have enough information on the offender and the crime, the information used comes from the offender — who may well minimize or deny the details and circumstances of his crime.

Offence	1991-92	1992-93	1993-94	1994-95	1995-96
Murder	30	21	17	16	15
Attempted Murder	24	17	9	13	15
Sexual Assault	48	43	43	49	22
Major Assault	39	34	27	25	21
Hostage Taking	6	1	4	5	3
Unlawful Confinement	11	19	9	3	5
Armed Robbery	64	88	102	113	71
TOTAL	222	223	211	224	152
Number of Supervised Offenders	9,112*	9,328*	8,452	8,057	7,824

* Total is inflated because it includes offenders deported, and temporarily in custody.

Exhibit 30.9

**Federal Offenders under
Community Supervision
Charged with Violent
Offences, Fiscal Year
Ending 31 March**

Source: Correctional
Service Canada

Both the provinces and Correctional Service have a role to play in resolving information-sharing problems.

may lead to an inaccurate assessment of criminogenic risks and needs and, consequently, to inappropriate programming and release decisions. Again, as noted in the National Parole Board review, the problem of information availability, and thus “over reliance on the offender’s version of the crime”, was a contributing factor in a number of poor-quality release decisions.

30.25 Since the passage of the Act in 1992, Correctional Service has been trying to formalize agreements with the provinces to obtain relevant information on the offender and the offence. Agreements have been negotiated with Quebec and the Atlantic provinces and, although documents are more readily available than before, information is not always available when Correctional Service needs it. After five years of negotiation, there is still no formal information-sharing agreement between the Service and the Province of Ontario, although we understand one is imminent.

30.26 Both the provinces and Correctional Service have a role to play in

resolving these problems. In the absence of being able to obtain all official source documents, the Service has not decided what minimum information is essential. Currently, the Service attempts to gather all available information for all offenders. The intake assessment process does not have a formal mechanism for deciding when enough information is available to finalize the risk assessment. Thus, as a first step, Correctional Service must decide what information at a minimum it needs to manage an offender’s risk. There will have to be co-operation between the Service and the provinces in reaching agreements that cover roles and responsibilities, and timeliness and relevance of information.

30.27 Correctional Service Canada should decide what information at a minimum it needs to manage offenders’ risks.

Correctional Service’s response: Correctional Service agrees that there is a critical set of information required to manage the risk of reoffending for different groups or categories of offenders, and will develop these requirements by January 1997. Such changes as may be required must be discussed and agreed upon with the National Parole Board so that it receives the information it needs for decision making.

30.28 Correctional Service Canada, in conjunction with its partners in the criminal justice system, should resolve the long-standing problem of acquiring relevant information on offenders in a timely manner.

Correctional Service’s response: The fundamental problem in this area is that, while the Correctional and Conditional Release Act creates a legal obligation on Correctional Service Canada (CSC) to obtain such information, there is little beyond the federal-provincial information-sharing agreements that

Exhibit 30.10
Percentage of Available Official Source Documents Prior to Placement

Region	Police Reports	Crown Counsel’s Brief	Judge’s Reasons
Atlantic (sample, 186) Jul 95 *	8%	5%	99%
Quebec (sample, 160) May 95	not tested	not tested	70%
Ontario (sample, 79) Feb 96	89%	32%	61%
Pacific (sample, 494) Jul 95	75%	10%	64%

* Availability could be higher due to reports gathered by parole officers.

Source: Correctional Service Canada Internal Audits and Studies

places obligations on agencies in the criminal justice system to provide such information. Because it is essential to carrying out CSC's reintegration activities, there will be renewed efforts by the Commissioner of Corrections and the Regional Deputy Commissioners to reach solutions to the specific problems with each province, including, if necessary, arrangements involving the use of CSC resources to obtain the required information. If these efforts prove unsuccessful, this issue will be addressed at the more senior federal-provincial level with ministers responsible for the administration of justice, to pursue either administrative agreements or legislative amendments.

Correctional Service does not always prepare the casework of offenders in time for their first parole eligibility date

30.29 Federal statutes require Correctional Service to maintain offenders in the least restrictive level of custody.

Thus, when offenders miss their parole dates because of slow case management, the Service may not be complying with its obligations. In addition to these concerns, failure to prepare an offender for safe release from custody at the earliest possible date has significant cost implications both in monetary terms and, more important, in terms of public safety when scarce resources are not used wisely. Furthermore, missed parole eligibility dates may also adversely affect offenders' chances for safe reintegration, since many criminologists believe that incarcerating an offender for too long is counter-productive.

30.30 There are many reasons why the casework of offenders is not processed more quickly. Some are within the Service's control, such as the amount of time taken to develop a correctional plan once the offender has been transferred from an assessment centre to an

Cases of Sensational Incidents with Missing Official Source Documentation

- in 11 of 60 cases (18%) police information was incomplete or not provided
- in 10 of 60 cases (17%) Crown information was incomplete or not provided
- in 7 of 60 cases (12%) judicial information was incomplete or not provided
- in 35 of 60 cases (58%) pre-incarcerate information was incomplete or not provided
- in 7 of 60 cases (12%) Board Members relied overly on self-reported information by the offender

Selected Quotes from the Report:

"...the police report provides information with respect to not only the nature of the offence but also the offender's state of mind and deportment upon arrest, along with the immediate effect upon the victim, important variables in the assessment of risk and in the treatment of the offender."

"With respect to Crown information, on occasion, the offender enters a guilty plea on the basis of a plea-bargain, therefore, the seriousness of the offender's crime and impact upon society may not be reflected accurately in the sentence of the Court."

"The presiding Justice may make statements with regard to how the offence is viewed from the perspective of the Court and what steps might be taken to ensure a safe reintegration of the offender into the community."

"It is evident that if the NPB is to ensure the protection of the public, then there has to be a better flow of information between all those involved in the criminal justice system who could have an effect on the quality of the work done by the Board..."

Exhibit 30.11

**National Parole Board (NPB)
Review of 60 Case Audits,
Special Inquiries and Boards
of Investigations between
December 1992 and
31 December 1994**

Source: National Parole Board,
February 1995

institution; others — for example, the length of time spent after sentencing at the provincial remand centre, and the National Parole Board requirement to have all case preparation submitted 21 to 28 days in advance of a hearing date — are beyond the control of Correctional Service.

30.31 During the audit, we examined two of the more obvious reasons why Correctional Service has difficulty preparing offenders to meet their parole eligibility dates: difficulty in obtaining official source documents, and extensive institutional program requirements.

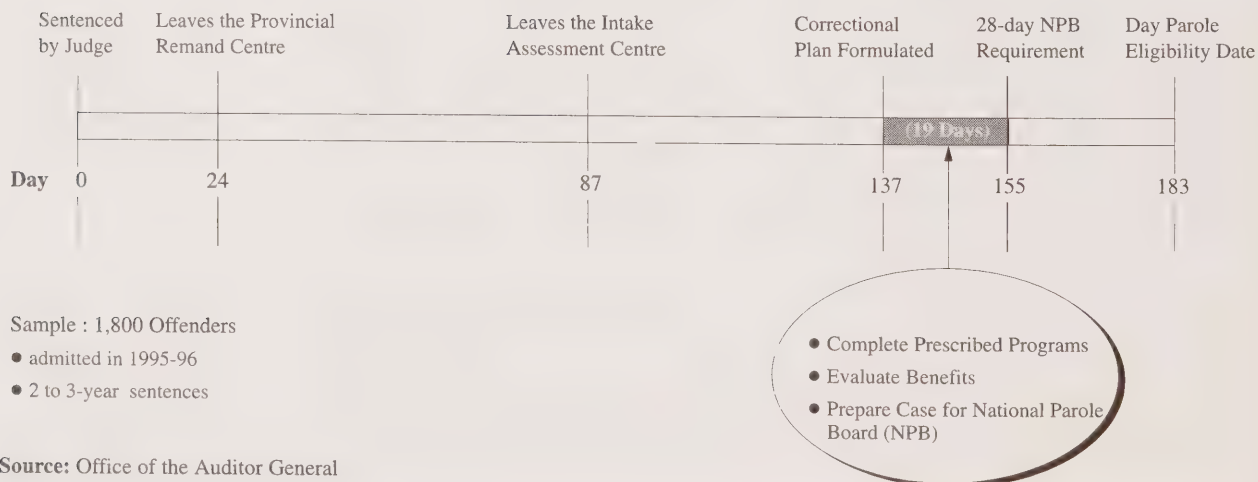
30.32 According to Correctional Service, if all key official documents were available as soon as an offender entered the regional assessment centre, initial assessments could be done in as little as 4 to 6 weeks instead of the 10 to 12 weeks it now takes in most regions. Late assessment produces a domino effect. Because of the lengthy initial assessment period, the placement of an offender in institutions is delayed. This in turn delays

preparation of the offender's correctional plan. Offenders cannot begin their programs without a plan, and many choose not to have a parole hearing until they have completed all the programs prescribed in the plan in order to increase their chances for a positive parole decision. Once an offender has completed the required programs, case management staff need time to determine whether the programs have produced any change in behaviour. The end result is that parole eligibility dates are missed.

30.33 The second reason why many offenders are likely to miss their parole eligibility date is extensive institutional programming. Many "criminogenic" needs (that is, problem areas that need to be addressed) are identified, and a correctional plan is developed to address all of them before the offender is released. Even low-risk/low-need offenders who could be expected to require relatively few programs still have extensive programming requirements. For example, in a sample of 50 low-risk/low-need offenders, we found that an average of

Exhibit 30.12

Average Time to Achieve Milestones in the Case Management Process



Source: Office of the Auditor General

three programs had been prescribed. Based on Correctional Service's current program curriculum, the shortest possible time in which an offender could complete the three programs would be 105 days.

30.34 Offenders with short sentences of two to four years are particularly affected because of delays in getting official information and also because of extensive programming. These offenders, who make up over 50 percent of all new admissions each year, become eligible for day parole within six to ten months after they have been sentenced. While pressure exists to prepare these inmates in time for their parole eligibility dates, there is also a counter-pressure within both Correctional Service and the National Parole Board to enrol the inmates in as many programs as possible in an institutional setting prior to their release, in the belief that this approach will increase long-term public safety.

30.35 To determine the extent to which the case management process prepares short-term offenders for their first parole eligibility date, we analyzed all of the approximately 1,800 offenders (368 were assessed as low-risk) admitted in 1995–96 with a sentence of three years or less. As Exhibit 30.12 shows, we found that, on average, four and a half months had elapsed before their correctional plans had been completed. This left an average of only 19 days to complete the prescribed programming, assess program benefits and

prepare and submit the case to the National Parole Board. If three programs had been prescribed for all of the 1,800 offenders in our sample (see paragraph 30.33), almost 100 percent would not have finished their programs until three months after becoming eligible for day parole. The total cost to keep an offender in an institution versus the community is approximately \$3,800 per month. We estimate that if all of the low-risk offenders in our sample were released at their first parole eligibility date, up to \$4 million in cost avoidance could be realized and then made available for reintegration activities.

30.36 There is additional support for our analysis of the difficulties faced by short-term offenders in being prepared in time for their first parole eligibility date. In February 1996, 270 first-term offenders who were serving sentences of four years or less were released. For those paroled, 150–200 days on average had lapsed since their first parole eligibility date. According to Correctional Service data, many hearings are postponed or waived due to incomplete programs or treatment, release plans and case preparation. For example, in the Ontario region, in 1995–96, almost 900 parole hearings (with long and short sentences) were waived or postponed because of incomplete release plans, treatment or programming. Data from the Prairies and Quebec yield similar results, as Exhibit 30.13 shows. In 1995–96, only 25 percent of day parole

Region	Waivers and Postponements			
	Due to Incomplete Programming	Due to Incomplete Release Plans	Due to Other Reasons	Total
Quebec	714	162	913	1789
Ontario	456	432	390	1278
Prairie	317	98	273	688

Exhibit 30.13

Waivers / Postponements Due to Incomplete Programs and Release Plans, 1995–96

Source: Correctional Service Canada Regional Offices

reviews for inmates (with long and short sentences) took place in the six months prior to their full parole eligibility date, according to National Parole Board data.

30.37 Correctional Service recently completed a Report on Parole Eligibility. The study identified a number of weaknesses in the Service's handling of parole eligibility dates, such as the need to increase the use of day parole and the need to focus more on low-risk offenders. A follow-on report identified the need to develop and use performance measures.

30.38 Correctional Service Canada should prepare the casework of offenders in time for their first parole eligibility date.

Correctional Service's response:
Correctional Service Canada (CSC) has initiated a comprehensive review of reintegration, which will examine how it is to meet its legal obligations. It must be clarified that short sentences do not automatically mean an offender is low risk, but they do mean the Service has very little time to complete the work required to prepare a case for decision at the day parole or full parole eligibility dates. CSC's clear obligation is to carry out the identification of risk and needs and complete the analysis of a wide range of factors that meets the standards of National Parole Board (NPB) decision-makers in a timely fashion, regardless of sentence length. The audit suggests that in the case of low-risk offenders, this work should be completed by the NPB deadline for first parole consideration, and this point is justified. Current work by CSC's Task Force on Reintegration focusses on identifying processes to prepare such cases for decision on an accelerated basis in order to focus resources on the more complicated and time-consuming work required for offenders with higher risk and need levels.

During our audits of Correctional Service, we interviewed many case management officers and found them to be a hardworking, dedicated group of professionals.

The Working Environment of Case Management Officers

Case management officers provide critical input to the decision to release

30.39 The recommendation made to the National Parole Board by case management officers on whether or not to release an offender is critical to the reintegration process as well as to ensuring the long-term safety of the public. During our audits of Correctional Service, we interviewed many case management officers and found them to be a hardworking, dedicated group of professionals. For case management officers to make quality recommendations on releasing an offender, a number of factors are essential in their working environment. Key among these are realistic caseloads, adequate support from other members of the case management team, an effective quality control mechanism for release recommendations and appropriate skills and training.

The absence of caseload standards affects the quality of release recommendations

30.40 Correctional Service does not have standards for the size of caseloads and the actual workload of individual case management officers can vary widely. The Service has not updated its caseload standards since 1970, even though case management activities have changed significantly since that time. For example, responsibility for preparing reports for the National Parole Board has been transferred from parole officers in the community to case management officers in the institutions.

30.41 During our interviews, none of the case management officers stated that they were able to complete all of the case management tasks specified in the Service's Case Management Manual. This

was attributed to the number of tasks unrelated to reintegration that they must complete and the caseloads they are assigned. Subsequently, we asked a sample of case management officers to complete detailed work diaries for a week in May 1996. We found that they perform many extracurricular tasks — perhaps as much as 20 percent of their time. These include assisting in security sweeps, arranging cell accommodations, attending to inmates' personal issues and frequently completing casework that is the responsibility of correctional officers. As a result, most inmates are seen by their case management officer only once every one or two months for 45 minutes.

30.42 Only the Quebec region has attempted to deal with the problem by using a formula to determine caseloads in institutions. Any institution in that region can make adjustments if necessary and if regional headquarters staff approve them. Neither senior management nor institutional management (except in the case of Quebec) has devoted enough attention to this important aspect of managing offenders. The wide variations in time available to monitor and assess an offender's suitability for parole ultimately affect the quality of the release decision. Caseload standards are essential to allow enough time for case management officers to become familiar with an offender and understand the risk that he may present when released.

Correctional officers do not fulfill their case management responsibilities

30.43 Correctional officers are responsible for both security and certain case management functions. According to Correctional Service policy, they are responsible for reporting to case management officers any changes they notice in the offenders they monitor as

primary caseworkers. This input is crucial to preparing assessment reports for the National Parole Board. However, correctional officers are not consistently performing their case management duties, even though their salary has been increased to compensate for these responsibilities. Management has been aware of this problem for a number of years; however, it has yet to resolve the issue. When correctional officers do not do their job, these responsibilities fall to case management officers who do not have line authority over correctional officers. As a result, the workload of case management officers becomes heavier, and they have less time to devote to preparing parole recommendations.

Initial training for case management officers is inadequate

30.44 Case management officers need appropriate training to perform their duties. While Correctional Service provides them with eight days of orientation training, many do not begin this initial training until after they start their job. Acting case management officers do not receive even this much training. By comparison, before starting the job, new correctional officers must complete a three-month training period. We also note that there is no requirement for Correctional Service to provide a certain number of training days per year for case management officers, and that few opportunities exist for them to meet on an annual basis to strengthen their skills and share professional experiences.

Quality control mechanisms for release recommendations are weak

30.45 Quality control is important in any process, but particularly where the process concerns decisions that involve public safety. Correctional Service has no standard approach to quality control for reports that are used by the National

Quality control is critical in monitoring parole recommendations made by staff who have different levels of experience or expertise.

Parole Board as a basis for making release decisions. We surveyed 12 institutions and observed wide variations in the approach to controlling the quality of casework. Correctional Service assigns quality control to unit managers and co-ordinators of case management. While unit managers are supposed to review all release reports for their units, they are largely involved in running the unit's day-to-day operations. Co-ordinators of case management perform only sporadic quality reviews of files and provide advice only on a functional basis. Furthermore, they are also responsible for regional training, consultations with the National Parole

Board and victims, and for reviewing detention and transfer applications.

30.46 We found, however, some isolated local initiatives aimed at improving quality. For example, the Quebec region has eliminated the co-ordinator position and has replaced it with senior case management officers. These individuals will be responsible for quality control and reviewing all casework in the unit. The objective of this initiative was to eliminate the randomness of quality control provided by co-ordinators. Another example is provided by the assessment unit in the Ontario region. It

Exhibit 30.14

Excerpts from Correctional Service's Internal Audits and Studies Pertaining to Poor Case Management Quality Control

"...in general, there is very little quality control with respect to the content of the Correctional Plans. While Unit Managers or Co-ordinators Case Management were found to have signed 89% of the 221 plans examined..., their signature was not a reliable guarantee of quality."

National Headquarters, 1993

Globally, Co-ordinators Case Management assume their role regarding case management but their involvement varies greatly from institution to institution, according to management's direction.

Auditors observed that Unit Managers do not really have the time necessary to properly fulfil their mandate.... Because Correctional Supervisors don't always do their job, Unit Managers must often assume these functions.

Quebec Region, 1993 (English summary)

"It was apparent during the course of interviews and file reviews that the Co-ordinator Case Management (CCM) has been largely delegated the role of quality controller for case preparation. While this may make sense in practical terms, as the CCM is the resident case management expert and often has more of a background in case management than the unit managers, the fact that the CCM has no line authority over case managers may impede his/her effectiveness."

Pacific Region, 1994

"Despite the fact that some institutions received good ratings for the presence of a countersignature on the report, the quality of the Progress Summary Reports as revealed by this audit questions the degree of quality control actually being exercised by supervisors."

"The role of the Co-ordinator Case Management includes the regular audit of case management functions at the institutional level. To our detriment, this particular aspect of their role has not been implemented to a measurable extent."

"...it is a significant challenge for case management staff to be knowledgeable and proficient in all areas. Because of this, it is difficult for Unit Managers to effectively supervise case management considering the myriad components of their jobs."

Ontario Region, 1995

"The Deputy Warden, Unit Managers and Co-ordinator Case Management (CCM) are all of the opinion that the CCM is the "case management expert" and that the Unit Managers have neither the background nor the expertise to adequately quality control case management reports. The Unit Managers do sign reports (after the CCM) but the apparent purpose in them doing so is really limited to maintaining an awareness of the casework performance of their staff."

Pacific Region, 1995

Source: Correctional Service Canada Internal Audits and Studies

has recently developed a case management checklist on new offenders to ensure completeness and accuracy of reports.

30.47 Quality control is critical in monitoring parole recommendations made by staff who have different levels of experience or expertise. We found that Correctional Service uses a large number of acting case management officers, who may or may not have the appropriate training. In addition, there is a high turnover among case management officers.

30.48 Correctional Service and the National Parole Board have both identified weaknesses in quality control. The Service's own studies confirm significant variations in the use of quality control mechanisms (see Exhibit 30.14). One of the clearest indications of the lack of quality control came from our survey of cases submitted to the National Parole Board for the month of May 1996 (see

Exhibit 30.15). We found that about 15 percent of the files were rejected by the National Parole Board and resulted in parole delays. This figure actually understates the problem because an even larger number of files had been incomplete when initially submitted to the National Parole Board and were only completed under pressure from the Board.

30.49 Correctional Service should set caseload standards for case management officers, ensure that correctional officers contribute to the case management process, implement quality control over the release recommendations and improve training for case management officers.

Correctional Service's response: The Task Force on Reintegration will identify critical work processes for reintegration as part of its overall review of reintegration. This identification may result in a redefinition of work required of staff and managers involved in the processes; and at that point Correctional

Exhibit 30.15

Cases Submitted by Correctional Service (CSC) to the National Parole Board (NPB) in May 1996

Region	Total Cases Submitted by CSC to NPB	Cases Submitted with all NPB Requirements	Cases with Missing Requirements Sent in Time to Avoid Parole Delays	Cases with Missing Requirements Resulting in Parole Delays
Atlantic	145	87 (60%)	43 (30%)	15 (10%)
Quebec	169	29 (17%)	118 (70%)	22 (13%)
Ontario	130	52 (40%)	52 (40%)	26 (20%)
Prairie	63	31 (49%)	21 (33%)	11 (18%)
TOTAL	507	199 (39%)	234 (46%)	74 (15%)

Source: National Parole Board/Office of the Auditor General

Service will be developing and/or revising caseload and training standards. The Task Force will also define quality control requirements at the three levels of the organization and plan their implementation.

Management of Reintegration Activities

30.50 Ensuring that activities aimed at safely reintegrating offenders are applied consistently across the country requires effort at all levels of the organization. This consistency is particularly important now that Correctional Service has become more decentralized. However, we found numerous examples in which standard practices were lacking and information on the results of case management activities was minimal.

Correctional Service has a number of initiatives designed to improve institutional case management

30.51 Correctional Service is aware of many of the difficulties it has with the case management function at institutions. It has carried out initiatives to both identify and resolve certain problems. For example, the Service conducted a study in 1995 on its ability to prepare offenders for release back into the community on parole. The study raised several problems, such as the management of offenders whose parole has been revoked, and the underuse of day parole. In 1996, Correctional Service prepared a study on practices used to detain offenders until the end of their sentences. The study raised several concerns, such as the ability of the Service to identify the right offenders for detention and the consistency of detention referrals across the country. To resolve problems in screening offenders when they first come into the federal system, Correctional Service standardized the initial assessment process in the five

regions. Notwithstanding these and other efforts, the Service has had limited success in improving its case management activities, as outlined below.

There is a lack of standard case management practices

30.52 Risk assessment report. The report submitted to the National Parole Board recommending whether or not parole is appropriate provides another example of the difficulty that Correctional Service has implementing standard practices on a national basis. The quality of this report has been a long-standing concern. In June 1994, a working group of Correctional Service and National Parole Board members agreed that a new reporting format was needed, and a new risk assessment report was developed. It is the key document in the case management process because it is designed to inform the Parole Board about the offender, analyze risk and provide a recommendation on parole. The regions were to lead the proposed project, which was to be piloted beginning in April 1995, with a target date for implementation by March 1996.

30.53 In March 1996, senior management observed three distinct variations in reporting practices across the regions. The Ontario, Quebec and Atlantic regions, for example, had decided not to follow the nationally approved reporting model. They chose not to include community parole officers in drafting the parole recommendation. Instead, they chose to leave it with the institutional case management officers. The Service continued the pilot project, while the National Parole Board implemented its part of the new approach in January 1996.

30.54 While Correctional Service clearly articulated its goal of improving the preparation of cases through this new report more than two years ago, regional

differences in reporting continue to exist. There is no standardized approach, and one does not appear imminent. The inability of Correctional Service to impose a standardized approach in this area raises a fundamental question about implementing standards or government policy on a nation-wide basis.

30.55 Revocations. In 1995–96, 7,481 offenders were released to the community on parole or statutory release. In the same year, 3,164 offenders were returned to custody. Of these, 32 percent were returned because they had committed a new offence while on release. The remaining 68 percent were returned because their release had been revoked for technical reasons. These reasons could include breaking a condition of release such as no drinking of alcohol or associating with known criminals. We found that Correctional Service has no national approach to handling this latter group of offenders. However, some regions have recognized the “potential” of continuing to reintegrate some of these offenders and have developed alternatives to returning them to prison. For example, in the Quebec region, transition houses are used to help offenders renew their reintegration efforts and to keep them from re-entering the federal system and starting the whole process again.

30.56 The Pacific region is using another approach. One case management officer has been dedicated to handling offenders whose release has been revoked. When possible, and with the offender and parole officer, this case management officer assists in developing new community-based approaches and options, such as further programming in the community or a short intensive program in an institution. Both the Quebec and Pacific regions indicate that these additional efforts continue the safe

reintegration of those offenders revoked for technical reasons. However, such initiatives, while laudable, need to be done under a framework where experimentation is encouraged, but approval to proceed is required, the results are monitored and a formal decision is made on whether to implement the initiatives across all regions.

Performance information is lacking

30.57 Performance information. Good performance information is lacking on the results of institutional case management activities. Admittedly, it is hard to measure performance, and other correctional systems have also experienced problems in this area. However, it is particularly important that Correctional Service have good performance information, especially because it has shifted responsibility for correctional operations from its national headquarters in Ottawa to its five regions, 46 institutions and 69 parole offices. Regions, in conjunction with individual institutions, are responsible for implementing policies developed at national headquarters. Management at all levels needs clear goals and targets as well as measurement systems to determine the extent to which case management activities are facilitating reintegration. During our audit, we encountered difficulties finding any data that measured the results of the Service’s reintegration activities. In many cases, we had to request the information be generated because it was neither available nor easily accessible.

30.58 Correctional Service does not have performance information on what happens to individual offenders after they have been released on day parole, full parole, statutory release or after their sentence has expired. We expected to find performance information (but did not), by

It is particularly important that Correctional Service have good performance information.

institution, on how well released offenders were doing in the community. If such analysis were available, it would be possible for Correctional Service to identify apparent anomalies, to conduct a more in-depth assessment of impediments to successful reintegration and to share lessons learned among institutions. We noted that the Service has made some effort to develop performance information. In 1996, it began an initiative to develop a number of national indicators for measuring performance. However, progress to date has been slow.

Recurring Audit Themes

Persistent weaknesses in managing reintegration activities

30.59 There is an underlying cause for the weaknesses that we have noted throughout this report: the failure of senior management to resolve the difficulties associated with case management in institutions.

30.60 This audit is the third in a series examining the reintegration activities of Correctional Service. In November 1994, we reported on an audit of the Service's expenditures of \$125 million on the supervision of 9,500 released offenders and, in May 1996, we reported on an audit of the \$75 million spent changing the behavioural and attitudinal patterns of offenders. Those two audits, along with this one on institutional case management, cover all of the Service's reintegration activities. All three audits point to recurring themes.

30.61 In the November 1994 Report, the chapter on community corrections noted that no accepted, standardized, professional practices existed for managing released offenders. For example, "sex offenders would be seen three times per week in one region, but

only once a month in another." There were "no district-wide or region-wide measures to determine the success of different practices in managing groups of high-risk offenders ... or of reliably assessing trends of such groups over time." The audit found that Correctional Service had problems implementing improvements in operational performance. Finally, we found that while there were "many good management practices for ensuring high-quality supervision", the Service was "not effective at identifying good practices and implementing them nationally where appropriate." The audit concluded that Correctional Service had "an institutional mindset", which caused the management of reintegration activities to "take second place." It recommended that senior Correctional Service management "provide more direction to the supervision of offenders in the community."

30.62 The May 1996 audit of rehabilitation programs noted wide variations in costs and methods used to treat offenders who pose a similar risk of reoffending. For example, in one region a high-risk sex offender may undergo a year-long residential program in a psychiatric facility, while in another region an equally high-risk sex offender might undergo a six-month, non-residential program. The audit stated that the Service has limited information on the cost and effectiveness of its reintegration programs and, therefore, it had no mechanism to reallocate funds to where they would make the most difference. For example, the Service spent 16 percent of the expenditure on substance abuse programs to treat 100 offenders, while the remaining 84 percent was spent on 5,000 offenders. Finally, the audit concluded that Correctional Service lacked the management framework and the attention from senior management

necessary to effectively guide the delivery of programs in accordance with its overall objective of reducing the rate of recidivism.

Conclusion

30.63 The findings emerging from these three audits have led us to conclude that there are systemic weaknesses in the Service's management of its reintegration activities and clear indications that senior management is not providing the attention these activities need. We found:

- a lack of commonly accepted work standards or practices;
- a lack of quality assurance procedures to ensure that standards and practices are being followed;
- a lack of performance information on the results of its reintegration activities in the institutions;
- difficulties in implementing basic changes or making improvements to operations (while many examples of good practices exist, Correctional Service needs to learn from its successes and failures); and
- a need to improve clarity of case management roles and the training and support for those involved in reintegration activities.

30.64 A framework should be developed by Correctional Service that encourages experimentation, but requires approval, monitors results and makes a formal decision whether to implement initiatives across all regions.

Correctional Service's response: Correctional Service's structure allows for experimentation; however, CSC agrees that a framework as described in the recommendation should be in place in order to gain maximum benefit from innovation. A framework differentiating

experimentation from standard policies, with national headquarters playing a key central role, will be in place by January 1997.

30.65 Correctional Service management should focus more attention on reintegration activities, particularly in the areas of developing performance information and implementing standard practices throughout the regions to ensure that the goal of safe reintegration is being consistently and diligently supported across the country.

Correctional Service's response: Correctional Service Canada (CSC) agrees that the weaknesses identified in the audit, and in internal CSC studies, require that senior management re-emphasize the importance of corporate attention to management practices; operational processes; and roles and responsibilities affecting reintegration. Accordingly, a structure at national headquarters making the senior Deputy Commissioner responsible for the correctional activities of CSC has been put in place, including a directorate specifically responsible for the policy framework affecting reintegration. In addition, a review of the major activities involved in the reintegration of offenders, specifically, case management, programming and community supervision, is being undertaken. This review will be proposing improvements to CSC's management of the reintegration activities, and short- and long-term improvements to the processes and activities involved at the operational level. The review touches upon issues raised in the 1994 Auditor General's report on community supervision and the May 1996 report on rehabilitation programs as well as the current report. It will be conducted in co-operation with the National Parole Board, and its final report is required by January 1997.

The findings emerging from these three audits have led us to conclude that there are systemic weaknesses in the Service's management of its reintegration activities.

Management Has Begun Corrective Action

Faced with the seriousness of the problems raised in this report, the Commissioner of Corrections has appointed a Task Force on Reintegration of offenders, to review the issues raised, identify solutions and develop a plan for corrective action. The Task Force is headed by the Senior Deputy Commissioner and the Deputy Commissioner for Women Corrections, and includes experienced senior managers from across the country as well as from the National Parole Board. The Task Force is due to report in January 1997.



About the Audit

Scope

We audited the role of institutional case management in reintegrating offenders back into society as law-abiding citizens. We reviewed the processes involved in assessing and preparing offenders for release. Excluded from the audit were reintegration activities related to community supervision and rehabilitation programs, as they were recently audited. The audit did not focus on female or Aboriginal offenders.

Objective

The objective of the audit was to determine whether the case management process is efficient and contributes to the reintegration of offenders. Specifically, we assessed whether there is:

- access to available information on offenders;
- a process to facilitate meeting offenders' parole eligibility dates;
- a working environment that fosters timely and effective preparation of offenders for release;
- a set of standardized practices; and
- performance information on the results being achieved.

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Report of the Auditor General of Canada to the House of Commons – 1996

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**Report of the
Auditor General
of Canada
to the House of Commons**

Chapter 31

Canadian Heritage – Parks Canada:
Preserving Canada's Natural Heritage

Chapter 32

Canadian Heritage – Parks Canada:
Management of Historic Canals

November 1996

**Report of the
Auditor General
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to the House of Commons**

Chapter 31

Canadian Heritage – Parks Canada:
Preserving Canada's Natural Heritage

Chapter 32

Canadian Heritage – Parks Canada:
Management of Historic Canals



November 1996

This November 1996 Report comprises 19 chapters, including "Matters of Special Importance", as well as a Foreword and the Main Points from the May, September and November 1996 Report chapters. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.

Chapter 31

**Canadian Heritage — Parks
Canada: Preserving Canada's
Natural Heritage**

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants.

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Canadian Heritage — Parks Canada: Preserving Canada's Natural Heritage

Assistant Auditor General: Robert R. Lalonde
Responsible Auditor: Harry A. Ruthnum

Main Points

31.1 Parks Canada administers 38 national parks, including two recently established ones, four national marine conservation areas and 131 national historic sites, including nine heritage canals. The system of 38 national parks covers approximately 225,000 square kilometres. In 1994–95, there were over 25 million visitors to the national parks, historic sites and heritage canals. The budget for 1996–97 is \$368 million.

31.2 The March 1996 federal Budget announced the government's intention to create a separate service agency to manage the Parks program. The new agency will manage, and preserve for future generations, a system of national parks, national historic sites and canals and related protected areas for the use and enjoyment of Canadians.

31.3 Overall, there is a need for Parks Canada to improve its knowledge about the state of the natural resources within national parks in order to implement a sound ecosystem-based management approach. This would help ensure that national parks remain or become unimpaired for the enjoyment of future generations, as required by the *National Parks Act*. We noted that:

- in the six national parks we reviewed, Parks Canada's biophysical information was out-of-date or incomplete except for La Mauricie; and
- although monitoring the ecological integrity of the ecosystems in national parks is a high priority according to Parks Canada policies and guidelines, in many national parks the Department has not monitored ecological conditions on a regular, continuing basis.

31.4 We are concerned that initiatives to increase visitation, if not carefully managed, could compromise the ecological integrity of national parks. Furthermore, adding new parks to the national system will put significant pressure on the resources that Parks Canada can allocate to each park to maintain and improve ecological integrity.

31.5 Of the 39 natural regions, 24 are currently represented by a national park. Since 1990, four new national parks have been established, all of which were under way before 1990. Given the rate of progress to date in creating new parks, the national parks system may not be completed as planned by the year 2000.

31.6 A number of candidate sites for national parks remain open to industrial development activities. We are concerned that these activities could harm the ecosystems and wildlife habitat that national parks are trying to protect, and impair their value as wilderness reserves.

31.7 Parks Canada has neither developed an action plan nor established a target date for completing the National Marine Conservation Areas System.

Introduction

The role of Parks Canada

31.8 Parks Canada is a program of the Department of Canadian Heritage. Its objective is “to commemorate, protect and present those places which are significant examples of Canada’s natural and cultural heritage for the benefit, understanding and enjoyment of the people of Canada, in ways which ensure the ecological and commemorative integrity of this heritage for the benefit of present and future generations.”

31.9 Parks Canada administers 38 national parks, including two recently established ones, five Canadian heritage rivers, four national marine conservation areas and 131 national historic sites, including nine heritage canals. The system of 38 national parks covers approximately 225,000 square kilometres. In 1994–95, there were over 25 million visitors to the national parks, historic sites and heritage canals. The budget for 1996–97 is \$368 million.

31.10 The 1988 *National Parks Act* states that “the National Parks of Canada are hereby dedicated to the people of Canada for their benefit, education and enjoyment...and shall be maintained and made use of so as to leave them unimpaired for the enjoyment of future generations.” In essence, the Act calls for the sustainable use of national parks. It also states that “maintenance of ecological integrity through the protection of natural resources shall be the first priority when considering park zoning and visitor use in a management plan.”

31.11 Parks Canada has divided Canada into 39 natural regions, each with distinctive physical and biological characteristics. The 1990 Green Plan sets out the federal government’s goal of

completing the national park system by the year 2000 by having a national park in each of the 39 regions. Parks Canada proposes to complete the system by achieving a negotiated national park agreement for each of the unrepresented natural regions or a permanent withdrawal of proposed national parklands from industrial development.

31.12 National parks help sustain wildlife populations and protect critical habitat, watersheds and rivers, and endangered species. They also assist in monitoring the health of the Canadian landscape by providing natural benchmarks against which to measure changes in natural ecosystems. National parks contribute to sustainable development by protecting representative ecosystems that define the Canadian landscape. Finally, when development of adjacent lands is proposed, the parks can help to keep it within sustainable limits because of the potential for transboundary impact.

31.13 In 1990, the Green Plan enunciated Canada’s long-term goal of setting aside 12 percent of its total territory as protected space. Also included in the Plan were the following specific measures relating directly to national parks:

- establish five new national parks by 1996;
- conclude agreements for 13 additional parks to complete the terrestrial system by the year 2000; and
- establish three new national marine parks by 1996 and a further three by the year 2000.

31.14 In 1986, the National Marine Parks Policy was approved, which committed Canada to protecting important examples of its marine environment. In 1987, Fathom Five National Marine Park

National parks are dedicated to the people of Canada for their benefit, education and enjoyment, and shall be maintained and made use of so as to leave them unimpaired.

National parks help sustain wildlife populations and protect critical habitat, watersheds and rivers, and endangered species.

**Parks Canada has
adopted the concept of
ecosystem-based
management.**

was established in Georgian Bay, by federal-provincial agreement with Ontario, as Canada's first national marine park. The 1986 policy was subsequently updated in 1994 by the National Marine Conservation Areas Policy to reflect more adequately the challenges of sustaining marine ecosystems and species.

31.15 The March 1996 federal Budget announced the government's intention to create Parks Canada as a separate service agency. The agency will have a mandate to manage, and preserve for future generations, a system of national parks, national historic sites and canals and related protected areas for the use and enjoyment of Canadians. Legislation to create the agency will be prepared.

Focus of the audit

31.16 Our audit focussed on the systems and processes that Parks Canada has in place to maintain, enhance and report on the ecological integrity in national parks. We also assessed the completion of the national parks system. Further details on the audit objective, scope and criteria are found at the end of the chapter in the section **About the Audit**.

Observations and Recommendations

Maintaining and Improving Ecological Integrity in National Parks

31.17 Parks Canada defines ecological integrity as "a condition where the structure and function of an ecosystem are unimpaired by stresses induced by human activity and are likely to persist."

31.18 Parks Canada carries out a wide variety of activities that are intended to

contribute to maintaining and improving the ecological integrity of national parks. These include investigations into poaching; monitoring environmental factors such as acid precipitation and water quality; and carrying out environmental impact assessments of proposed capital works. Attaining ecological integrity in national parks involves a long-term commitment by Parks Canada. The results of its efforts often occur over long periods and may not be immediately apparent.

31.19 Parks Canada has adopted the concept of ecosystem-based management. This implies pursuing goals of ecological integrity using a comprehensive approach to protecting an ecosystem that may be greater than the size of the park. This approach is based on knowledge of the human and naturally induced stresses that affect these ecosystems, and a recognition that such ecosystems are constantly changing. Ecosystem-based management therefore demands actions based on appropriate information and coherent plans to reduce stresses so that ecosystems can evolve naturally over time.

31.20 This contrasts with earlier approaches, which usually focussed on protecting individual species or analyzing the linear relationships of specific food chains or cycles. Ecosystem-based management relies heavily on monitoring changes and assessing the impacts of stress on an entire ecosystem.

Managing to achieve ecological integrity

31.21 In our opinion, Exhibit 31.1 represents prerequisites that relate directly to managing with a view to achieving ecological integrity.

31.22 To the extent that these prerequisites or "building blocks" are in place, it will be possible to manage in a way that will allow Parks Canada to

maintain and improve the ecological integrity of national parks. Conversely, if any of these building blocks are lacking or weak, there is a risk that some or all ecological objectives will be compromised to some degree.

31.23 This section of the chapter presents our findings in relation to these prerequisites. Our findings on accountability appear under “Accountability to Parliament”, paragraphs 31.81 to 31.90. We have also included observations on Parks Canada’s efforts to communicate information on ecology to visitors to national parks and to the public in general (paragraphs 31.47 and 31.48).

31.24 Exhibit 31.2 displays basic facts about conditions affecting the six parks we reviewed as part of the audit. The concepts and terms included in the exhibit are explained in this section.

Planning does not always provide a clear link between ecological integrity objectives and initiatives

31.25 The park management plans provide strategic direction for the protection of park ecosystems. However, we noted that the management plans for 18 parks were more than five years old; the average age was about 12 years, even though the *National Parks Act* and policy require that management plans be reviewed every five years. Moreover, in 9 parks the ecosystem conservation plans, which provide more precise direction on the protection of ecological integrity in each park, are more than five years old. Parks Canada’s *Guide to Management Planning* suggests that these plans be updated within five years.

31.26 These plans were developed before Parks Canada had articulated its current ecosystem-based guidelines and

policies. Delays in preparing management plans and ecosystem conservation plans reduce Parks Canada’s ability to preserve the ecological integrity of national parks. For example, they complicate the incorporation of stronger ecosystem conservation goals and practices, which are required by the 1988 revisions to the *National Parks Act* and Parks Canada’s subsequent ecosystem-based guidelines and policies. Furthermore, 13 parks reported that they did not have a fully completed ecosystem conservation plan.

31.27 Except for Pacific Rim National Park Reserve, the management plans of the six parks that we reviewed did not provide a clear link between ecological integrity objectives and initiatives. Nor were the business plans linked clearly to the management plans. Business plans are intended to define how management plan initiatives will be implemented. Consequently, it is difficult to assess how ecological integrity initiatives will be implemented to achieve strategic objectives and whether Parks Canada plans to allocate its resources according to those objectives. Parks Canada also has no formal process for monitoring the implementation of management plans or reviewing previous initiatives.

31.28 We are concerned that in some instances, management plans emphasize

Delays in preparing management plans and ecosystem conservation plans reduce Parks Canada’s ability to preserve the ecological integrity of national parks.

Exhibit 31.1

Prerequisites to Managing with a View to Achieving Ecological Integrity

- Plans that reflect ecological integrity objectives and Parks Canada’s mandate and policies
- Information on the impact of visitor use and on the condition of park ecosystems (essential for decision making)
- Establishment of indicators of ecological integrity
- Mechanisms for monitoring the condition of ecosystems according to these indicators
- Reporting on accountability for meeting ecological integrity objectives

social and economic factors over ecological factors. This may be reflected in decisions relating to the development of park facilities and the extension of commercial leases. Our concern applies particularly to Banff and Jasper national

parks, which have experienced substantial commercial development in recent years.

31.29 Parks Canada should ensure that park management plans are updated in accordance with the

Exhibit 31.2

Conditions Affecting the National Parks Reviewed

Fundy	<ul style="list-style-type: none"> • Landscape formerly disturbed by logging and agriculture • Significant facility and infrastructure development (roads, golf course, accommodations) • Member of Fundy Model Forest Program • Outdated, inadequate biophysical database • Limited monitoring of ecological integrity • No information on the acceptable level of visitor use
La Mauricie	<ul style="list-style-type: none"> • Landscape formerly disturbed by logging and agriculture • Existing comprehensive biophysical and critical species information • Ongoing monitoring of indicator species and selected vegetation • No information on acceptable level of visitor use
Point Pelee	<ul style="list-style-type: none"> • Small park surrounded by intensively developed lands • Extensive infrastructure development (roads, facilities) • Advanced vegetation restoration and rehabilitation program • Incomplete, inadequate biophysical database • Monitoring of ecological integrity mainly limited to rare species • No information on acceptable level of visitor use despite high number of visitors
Riding Mountain	<ul style="list-style-type: none"> • Concentration of intensive recreational activities such as golf course in and around town site • Severe external stress on critical wildlife such as the timber wolf • Outdated, inadequate biophysical database • No program for monitoring ecological integrity • Preliminary efforts toward greater park ecosystem planning • No information on acceptable level of visitor use despite intense use
Yoho	<ul style="list-style-type: none"> • Montane areas disturbed by transportation corridor • Biophysical database inadequate but being upgraded • Monitoring of ecological integrity limited to endangered species • Limited information on acceptable level of visitor use
Pacific Rim	<ul style="list-style-type: none"> • Ecologically inappropriate linear shape fragmented by logging and road corridors • Identified in Interim Management Guidelines as having "experienced a significant net loss of ecological integrity since establishment" • Biophysical database requires improvements • Monitoring of ecological integrity limited to endangered and other specific species • Consultations on greater park ecosystem, results starting to show • Collection of information on acceptable level of visitor use ongoing but not yet complete

requirements of the *National Parks Act* and policy, and business plans should be clearly linked to those management plans. Parks Canada should also introduce a formal process for monitoring the implementation of management plans.

Department's response: Agreed. Parks Canada is currently assessing the links between the management planning process and business planning process to ensure that key accountabilities such as ecological integrity are respected in both planning and plan implementation. Mechanisms to assess the implementation of management plans do exist through the annual cycle of business plans and work plans. These will be reviewed and strengthened as necessary.

Parks Canada lacks key information necessary for park management

31.30 Good information is a cornerstone of managing parks in an ecologically responsive manner. However, we found that Parks Canada's information base was weak in two key areas, as discussed below. Because it lacks essential information, Parks Canada risks making decisions on park management that may not be sound in terms of maintaining and improving ecological integrity.

31.31 Increasing visitor traffic in national parks could compromise ecological integrity. Parks Canada's marketing strategy is expected to attract more Canadian and international visitors for longer stays in national parks. This strategy is also expected to increase the number of visitors in off-peak seasons. We are concerned that Parks Canada's ability to preserve ecological integrity in national parks and ensure sustainable park use will be seriously challenged. Furthermore, adding new parks to the national system will put significant pressure on the resources that Parks Canada can allocate

to each park to maintain and improve ecological integrity. This financial pressure is likely to increase as government resources become even more constrained over time.

31.32 Given Parks Canada's intention to promote national parks extensively, and given the significant risk to ecological integrity associated with increased visitation, comprehensive information on the ecologically acceptable level of visitor use in national parks is important. We noted a lack of such information in the parks that we reviewed. Furthermore, determining the acceptable level of visitor use is complicated by the absence of measurable objectives for ecological integrity. The lack of such information reduces Parks Canada's ability to ensure the sustainable use of national parks and may result in the degradation of ecologically sensitive areas that are most accessible to the public.

31.33 The risk to ecological integrity posed by high numbers of visitors is real, and has been recognized in existing parks. The ecological sustainability of the "Four Mountain Parks" area (Banff, Jasper, Kootenay and Yoho national parks) is of particular concern. The number of visitors in these parks increased by 25.7 percent between 1988–89 and 1994–95. In 1994–95, there were 8,650,000 visits to this area. By comparison, the number of visitors to other national parks during the same period increased by 13.7 percent.

31.34 The ecologically sensitive Bow Valley accommodates a large proportion of the visitors to the Four Mountain Parks area, and Parks Canada recognizes that it has already been significantly impaired by human activity and development. The terms of reference of the Banff Bow Valley Study, commissioned by the Minister for Canadian Heritage,

Good information is a cornerstone of managing parks in an ecologically responsive manner.

The risk to ecological integrity posed by high numbers of visitors is real, and has been recognized in existing parks.

Parks Canada has not systematically collected scientific data on natural resources and monitored changes in their condition over time.

Parks Canada has had some positive results in maintaining and improving the ecological integrity of national parks.

highlighted the need to provide for sustainable use of the Bow Valley and to protect the natural values of Banff National Park. Nevertheless, a recent initiative of the Department of Canadian Heritage (Roads to Canada's Great Drives) heavily promoted the Bow Valley as an attraction.

31.35 On-site staff in national parks were consulted to determine their views on the extent to which the parks are used. According to staff, two thirds of national parks are experiencing some degree of "overuse or crowding". As well, the consultations revealed that increased visitation is beginning to cause environmental problems in some northern parks.

31.36 Parks Canada should determine the acceptable level of visitor use for each park in order to preserve ecological integrity in national parks.

Department's response: We agree with the observation that Parks Canada should determine the acceptable level of visitor use for each park in order to preserve its ecological integrity. The recently released Banff-Bow Valley Study is an excellent example.

31.37 Baseline biophysical information needs to be improved. Preserving the integrity of ecological systems in national parks requires collecting data on park resources and maintaining and updating biological, ecological and physical information. It also requires doing scientific research on the status of ecosystems and monitoring their condition over time in order to detect changes and take corrective measures.

31.38 Parks Canada has not systematically collected scientific data on natural resources and monitored changes in their condition over time for all the national parks. We found that the

biophysical information Parks Canada did have for the six parks we reviewed, other than La Mauricie, was frequently out-of-date or incomplete. Without this critical information, Parks Canada will have difficulty assessing the condition and trend of natural resources in these national parks, including species at risk. This increases the risk that Parks Canada will be unable to protect ecological integrity in these parks.

31.39 In response to our survey of the national parks, 14 parks reported that they had no scientific research strategy for gathering data to address ecosystem-based management questions. Of the 22 parks that did report having such a strategy, 11 said that it was not part of the scientific research framework for the park's administrative region. This reduces Parks Canada's assurance that research is effectively responding to park and regional management needs for information related to ecological integrity.

31.40 Despite these weaknesses, Parks Canada has had some positive results in maintaining and improving the ecological integrity of national parks. For example, it is working with other government agencies, industry, Aboriginal people and adjacent landowners to encourage compatible management practices in national parklands and adjacent areas. The intent is to minimize the impact on national park ecosystems of activities taking place outside park boundaries. For example, in La Mauricie and Point Pelee national parks, a number of joint research projects and other collaborative initiatives have had a positive impact on ecological integrity. As a result of one such initiative, the stocking of lakes that lie outside the boundaries of La Mauricie National Park but are connected to water bodies inside the park has been stopped. In Point Pelee National Park, local commercial nurseries

have reduced the marketing of non-native plants. As a result of both changes, the modification of the natural processes in both parks has been reduced.

31.41 Parks Canada's partnership arrangements continue to play a significant role in its efforts to maintain the ecological integrity of national parks. For example, its involvement in the Fundy Model Forest Program has permitted Fundy National Park management to gather and analyze a significant amount of data in a relatively short period of time at less cost than if it had tried to do so on its own. One of the goals of this program is to ensure the environmental sustainability of the greater park ecosystem.

31.42 Parks Canada should improve the quantity and quality of its baseline biophysical data in order to respond to ecosystem-based management questions with a view to preserving ecological integrity in national parks.

Department's response: Agreed.

Determination of indicator species of ecological integrity is not completed

31.43 Many monitoring projects focus on determining the state of health of particular species. Some of this information can then be used as an indication of the general health of an ecosystem. For example, Parks Canada uses the condition of the loon population as one of a number of indicators of ecological health in La Mauricie National Park. Similarly, it uses the condition of the pine marten as an indicator of ecological health in Fundy National Park. However, our survey of the national parks showed that 15 parks have not established indicator species of ecological integrity, and 11 others have only incomplete sets of indicators. Indicators such as these, if available, could be used to detect changes

in ecosystems. The lack of indicators of ecological integrity also complicates the identification of the ecological aspects on which Parks Canada needs to focus its monitoring. This reduces its assurance that monitoring will yield useful information for park management.

Monitoring of the ecological conditions in national parks is incomplete

31.44 Monitoring the ecological condition of the ecosystems in national parks is a high priority, according to Parks Canada policies and guidelines. However, in many national parks, the ecological conditions are not monitored on a regular, continuing basis. In response to our survey of the national parks, 16 parks reported that they had no program for monitoring ecological integrity. Another nine reported that they had one, but that it was only partly developed.

31.45 Without an effective monitoring program based on valid indicators, the risk increases that Parks Canada will not be able to detect problems that may be affecting ecological integrity and take remedial action. To illustrate the risk associated with shortcomings in monitoring, effluent from a settlement pond is being drained into an adjacent wetland at the Wasagaming town site in Riding Mountain National Park, to reduce the amount of toxic residue polluting a lake. However, Parks Canada does not monitor the wetland area to determine whether, or to what extent, the effluent is causing damage to the area and the wildlife species associated with it.

31.46 Parks Canada should develop an effective system for monitoring the ecological conditions in all national parks.

Department's response: Agreed. Parks Canada's current work has placed it in a leadership role in the development of this

Partnerships play a significant role in Parks Canada's efforts to maintain the ecological integrity of national parks.

Fifteen parks have not established indicator species of ecological integrity.

Parks Canada could do more to communicate information that would help it explain and protect the ecological features of national parks.

Currently, 24 of the 39 natural regions are represented.

field. Parks Canada is regarded as an important partner in Canada's Environmental Monitoring and Assessment Network.

Interpretation and public education programs could contribute more to preserving ecological integrity in national parks

31.47 Information and interpretation are identified in Parks Canada's policies as "principal means of achieving its protection and presentation objectives". Information and interpretation programs provide information to park visitors and the public in general to help them understand, appreciate, enjoy and protect Canada's national parks. These programs are also aimed at providing opportunities for members of the public to acquire knowledge and skills that will help them to make environmentally responsible decisions on a day-to-day basis.

31.48 Our survey of the national parks showed that of the 28 most accessible, 19 have not developed a strategy to communicate information about ecological integrity. As well, the level and content of information on ecological integrity provided in the different parks is inconsistent, as in some instances the linkage between communication and protection of natural resources needs to be strengthened. Consequently, assurance that ecological integrity information is delivered effectively is reduced. The information presented in the visitor centres at Riding Mountain, Fundy and Pacific Rim national parks tended not to relate to broader environmental issues and thus did not convey a message of ecosystem protection. In our opinion, Parks Canada could do more to communicate information that would help it explain and protect the ecological features of national parks.

31.49 Given the potential for benefiting ecological integrity, Parks Canada should strengthen public education programs to better communicate ecological information to park visitors and Canadians in general.

Department's response: Agreed. Among current initiatives, Parks Canada is a sponsor of both the Discovery Channel's Great Canadian Parks series and an educational video series by noted ecologist Dr. Stan Rowe.

New Park Establishment

31.50 The federal government's goal is to complete the national park system by representing each of the 39 terrestrial natural regions in the system of national parks by the year 2000. Each national park is to represent the biological and physical characteristics found in its natural region, and contribute to maintaining the area's ecosystems in as healthy a state as possible.

The national parks system may not be completed by the year 2000

31.51 Of the 39 natural regions, 24 are currently represented by a national park (Exhibit 31.3). Since 1990, four new national parks have been established, all of which were under way before 1990 (Aulavik, Vuntut, Wapusk and Tuktut Nogait). The latter two were established in 1996. One national park, Vuntut, was established in the Northern Yukon region, which was already partially represented by Ivvavik National Park. Also, land acquisition is currently under way to establish the Gulf Islands National Park in southern British Columbia.

31.52 Given the rate of progress in creating new national parks to date, the low activity in over half of the natural regions still unrepresented and the number of unconfirmed potential park sites, the national parks system may not be

completed as planned by the year 2000. Today, less than five years before the deadline, Parks Canada is negotiating with provincial and territorial governments, Aboriginal people and local communities to establish parks in 7 of the 15 remaining natural regions. Our audit noted that in three inactive regions, there are no negotiations due to a lack of support from other governments and local communities. The other five regions lack specific proposals for negotiation, making them inactive natural regions as well.

31.53 Failure to represent each of Parks Canada's terrestrial regions could undermine the federal government's protected-area commitments originally made in Canada's Green Plan (1990) and the Tri-Council Statement of Commitment to Complete Canada's Networks of Protected Areas (1992). It could also indicate a failure to meet Canada's international commitment to establish a network of protected areas to conserve biological diversity, as stated in the Biodiversity Convention (1992).

Parks Canada has neither established nor publicized its priorities for each natural region

31.54 In our 1989 audit, we recommended that Parks Canada establish a target date and priorities for completing the system. In the 1990 Green Plan, the federal government made a commitment to complete the terrestrial national parks system by the year 2000. This goal was subsequently confirmed in 1994. To date, however, Parks Canada has neither established nor communicated clear priorities for establishing a park in each of the unrepresented natural regions. It has indicated only that its priority is to establish new national parks in the seven natural regions that already have active proposals.

31.55 Parks Canada updated its National Parks System Plan in 1990, and in 1992 prepared a Draft Action Plan for Completing the National Parks System Plan. The System Plan provides a general overview of the features Parks Canada wants to protect in each natural region. It also indicates the status of planning in each unrepresented natural region and describes the five-step approach to park establishment:

- identifying representative natural areas;
- selecting potential park areas;
- assessing park feasibility;
- negotiating a new park agreement; and
- establishing a new national park in legislation.

31.56 The Draft Action Plan reviewed the steps to establishing new national parks and the status of planning in the unrepresented natural regions. It also set target dates for advancing work in unrepresented natural regions. However, most of these target dates have passed.

31.57 Parks Canada should update and release its National Parks System Plan and Action Plan for Completing the National Parks System.

Department's response: The system plan is in the process of being updated. The current action plan will continue.

Parks Canada has not been sufficiently proactive in getting support for new national parks

31.58 One challenge that Parks Canada must overcome to successfully negotiate new national park agreements is obtaining the support of provincial and territorial governments, Aboriginal people, and local communities. Securing such support can take years. In the case of a proposed

Completing the National Parks System

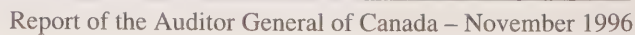


Exhibit 31.4

Progress in Completing the National Parks System

National Park Terrestrial Natural Regions

	Identify Areas of Interest	Select a Specific Park Proposal	Feasibility Study	Negotiations for Final Agreement	Park or Reserve Protected by National Parks Act
	1	2	3	4	5
Western Mountains					
1. Pacific Coast Mountains (Pacific Rim, Gwaii Haanas)					
2. Strait of Georgia Lowlands (Southern Gulf Islands Proposal)					
3. Interior Dry Plateau (Churn Creek Area of Interest)					
4. Columbia Mountains (Glacier, Mount Revelstoke)					
5. Rocky Mountains (Banff, Jasper, Kootenay, Yoho, Waterton Lakes)					
6. Northern Coast Mountains (Kluane)					
7. Northern Interior Plateaux and Mountains					
8. Mackenzie Mountains (Nahanni)					
9. Northern Yukon Regions (Ivvavik, Vuntut)					
Interior Plains					
10. Mackenzie Delta (Ivvavik)					
11. Northern Boreal Plains (Wood Buffalo)					
12. Southern Boreal Plains and Plateaux (Prince Albert, Wood Buffalo, Riding Mountain, Elk Island)					
13. Prairie Grasslands (Grasslands)					
14. Manitoba Lowlands					
Canadian Shield					
15. Tundra Hills (Tuktut Nogait**)					
16. Central Tundra Region (Wager Bay Proposal*)					
17. Northwestern Boreal Uplands (East Arm of Great Slave Lake Proposal*)					
18. Central Boreal Uplands (Pukaskwa)					
19. West Great Lakes-St. Lawrence (La Maurice, Georgian Bay Islands, St. Lawrence Islands)					
20. Laurentian Boreal Highlands					
21. East Coast Boreal Region (Mealy Mountains Proposal)					
22. Boreal Lake Plateau (Lac Guillaume-Delisle Proposal)					
23. Whale River Region					
24. Northern Labrador Mountains (Torngat Mountains Proposal)					
25. Ungava Tundra Plateau					
26. Northern Davis Region (Auyuittuq)					
Hudson Bay Lowlands					
27. Hudson-James Lowlands (Wapusk)					
28. Southampton Plain					
St. Lawrence Lowlands					
29. St. Lawrence Lowlands (Georgian Bay Islands, Point Pelee, Bruce Peninsula, Mingan Archipelago)					
Appalachian					
30. Notre-Dame Megantic Mountains (Forillon)					
31. Maritime Highlands (Fundy, Cape Breton Highlands)					
32. Maritime Plain (Kouchibouguac, Prince Edward Island)					
33. Atlantic Coast Uplands (Kejimikujik)					
34. Western Newfoundland Island Highlands (Gros Morne)					
35. Eastern Newfoundland Island Atlantic Region (Terra Nova)					
Arctic Lowlands					
36. Western Arctic Lowlands (Aulavik)					
37. Eastern Arctic Lowlands (North Baffin Island*)					
High Arctic Islands					
38. Western High Arctic Region (Bathurst Island Proposal*)					
39. Eastern High Arctic Glacier Region (Ellesmere Island)					

* Lands withdrawn to provide interim protection

** Work continues toward establishing the portion of the park located in Nunavut

Source: Parks Canada Administration October, 1996

Industrial development activities could harm the ecosystems and wildlife habitat that national parks are trying to protect.

national park in the Northwest Territories, it took 16 years before local communities were prepared to negotiate a park agreement. Such support still has not been secured for a proposed national park in southern British Columbia. Achieving local support, in particular, is a fundamental requirement of federal parks policy. Parks Canada's ability to achieve a national park agreement for six of the seven active national park proposals, and two of the three inactive national park proposals, will depend to a considerable extent on securing the support of local people.

31.59 Parks Canada needs to assign more priority to securing provincial and local support for new national parks in the eight inactive natural regions. Failure to do so leaves candidate sites open to industrial development, and other land-use decisions that could prevent the creation of a new national park. We noted the lack of a strategic approach, for example, infrequent use of outside professionals and community-based workshops to assist in bringing together Parks Canada, provincial and territorial governments, Aboriginal people, local communities and other interested parties to examine the challenges and potential opportunities for action, particularly in the inactive natural regions. By simply waiting for other governments and local communities to adopt favourable positions, Parks Canada is reducing the likelihood of achieving representation in several natural regions and maintaining ecological integrity.

31.60 Parks Canada should develop a more strategic and proactive approach to achieving provincial, territorial, Aboriginal and local support for candidate park sites, thus allowing it to complete the national parks system on a timely basis.

***Department's response:** The Department believes that Parks Canada has adopted a strategic and proactive approach. It is important to recognize that provincial and territorial, Aboriginal and local support must be earned through dialogue and consultation, always in conjunction with legitimate demands and desires for other land uses.*

Some potential national parks remain open to industrial development activities

31.61 A number of candidate sites for national parks remain open to industrial development activities. We are concerned that these activities could harm the ecosystems and wildlife habitat that national parks are trying to protect, and impair their value as wilderness reserves. Interim measures are needed to protect these potential parks from development until negotiations on the feasibility of creating a new national park are concluded. Failure to do so could raise the cost of creating new parks in the future if Parks Canada has to compensate developers for stopping their work and losing their tenure or licenses. Giving developers access to potential national parklands could also jeopardize the public consultation process.

31.62 Mineral staking has already occurred in several potential national parks in the south. As well, areas of moderate to high mineral potential within the boundaries of several proposed northern national parks have been identified, which could result in mineral staking before Parks Canada has concluded negotiations for establishing these parks. The federal government cannot apply interim protection measures to the southern national park candidates because the land is provincial Crown land. However, it can do so in the Northwest Territories.

31.63 It is the policy of the federal government to ensure that an inventory of the non-renewable natural resource potential of areas in the territories be compiled prior to their formal establishment as new national parks. The government conducts mineral and energy resource assessments to ensure that the economic and strategic significance of mineral and energy resource potential is duly considered in the process of new park establishment. Until such assessments are complete, candidate sites remain legally open to mineral prospecting and staking activities. For example, we observed one instance where mineral prospecting permits were issued for areas proposed for inclusion in Tukut Nogait national park before negotiations between Parks Canada and a northern Aboriginal community were concluded. As a result, negotiations to complete the park were delayed.

31.64 Parks Canada should continue to try to convince other jurisdictions and federal departments to use their legislative powers to withdraw candidate national park sites from development as early as possible to preserve their ecological integrity.

Department's response: Agreed. This is already being done, with demonstrated success.

Parks Canada has not pursued alternative approaches to land ownership

31.65 The *National Parks Act* requires the federal government to administer and control surface and sub-surface rights within the legislated boundaries of newly created national parks. When a national park is created in southern Canada, the province must transfer provincial Crown lands to the federal government before they can be administered under the Act. In northern Canada, most lands are

administered either by the federal Crown or by Aboriginal people. Recent land claims settlements such as the 1993 Nunavut Land Claims Agreement set out the terms and conditions under which new national parks can be established.

31.66 The goal of the federal government is to represent each of the 39 natural regions with a national park where the federal government owns the land. Ideally, provincial governments and the federal government would work together in completing the national park system. One impediment to their doing so is that in several natural regions, the provincial government that administers the land will not transfer candidate national parks to the federal government. The need for the federal government to own the land limits alternatives. It could also increase the cost of establishing new parks, particularly if such lands are allocated to development interests before a potential national park has been identified, negotiated and established. We believe that flexibility on the issue of ownership of specific sites is essential if all natural regions are to be represented on time and at reasonable cost. In fact, both the federal Task Force on Park Establishment (1987) and the Canadian Environmental Advisory Council (1992) suggested that Parks Canada consider recognizing protected areas managed to national park standards in those natural regions where federal ownership of national park lands is not possible.

31.67 Clearly, innovative approaches to federal ownership will be needed to negotiate the use of the land to represent some of Parks Canada's natural regions. In such cases, Parks Canada may seek government approval to change its goal and accept representation of a natural region by some means other than a national park, using legislation other than

Where federal ownership is not possible, innovative approaches will be needed.

the *National Parks Act* to protect the lands and waters. For example, we noted that a limited application of this approach worked in the case of Grasslands National Park. In Grasslands, the Saskatchewan government maintains ownership of the park's major watercourses, while delegating authority under provincial parks legislation to Parks Canada to manage the watercourses to national park standards. Similarly, the British Columbia government passed provincial legislation allowing Parks Canada to administer Pacific Rim as a national park until the area is proclaimed under the *National Parks Act*.

31.68 If certain natural regions are to be represented by a protected area other than a national park, Parks Canada needs to analyze the impact and benefit of varying the traditional national park approach. It needs also to ensure that there is public support for such an approach, given that the goal to complete the national park system by the year 2000 through the creation of national parks administered under the *National Parks Act* was supported in two extensive national consultation programs between 1989 and 1994. A major benefit of such an approach is that the ecological integrity of nationally significant natural areas could be achieved more quickly, and not lost to potential development while jurisdictions discuss issues related to land transfer.

31.69 For those natural regions where the need to own the land becomes an impediment, Parks Canada needs to be more proactive in finding another approach. For example, it needs to work with the relevant provincial jurisdictions to jointly identify a potential park site that meets the federal and provincial goals for representation. Once the site has been confirmed, the provincial government needs to be encouraged to apply interim

protection measures while the federal and provincial governments develop a joint conservation strategy for protecting the area to national park standards.

31.70 Parks Canada should continue to represent each natural region by a national park where federal ownership is possible. Where it is not possible, Parks Canada should study alternatives, and recommend that the government:

- consider the implications of alternative approaches to represent those natural regions, on a case-by-case basis;
- consider federal recognition of such protected areas where the provincial government agrees to protect and manage them to national park standards under provincial legislation; and
- subject such alternative approaches to public consultation, to ensure public support for a change to the federal government's goal of representing several specific natural regions with a national park.

Department's response: Parks Canada, pursuant to government direction, will maintain the course that leads to national parks being owned by all Canadians and managed on behalf of all Canadians.

Not all natural regions are adequately represented

31.71 In the early 1970s, Parks Canada adopted the concept of "representation" to guide its selection of new national park sites. Its goal is to protect representative examples of the Canadian landscape in each of the 39 natural regions. Potential national parks must represent the geology, physiography, vegetation, wildlife and ecosystem diversity that are characteristic of the natural region in which they are situated. The degree to which a national park adequately represents a natural region depends on how well its final

Potential national parks must represent the geology, physiography, vegetation, wildlife and ecosystem diversity that are characteristic of the natural region in which they are situated.

boundary captures, or represents, all of the natural features that define a natural region. Park boundaries must also be large enough to ensure that natural evolutionary processes continue.

31.72 We reported in 1989 that Parks Canada would conduct a region-by-region assessment of the adequacy of representation of the natural regions by existing parks. This review has not been done.

31.73 Such a review is important because parks in 12 of the 24 natural regions deemed represented by a national park were created before the system plan was adopted. Accordingly, the design of these parks was not based on the criterion of representation. As a result, the parks may not adequately represent their respective natural regions.

31.74 Parks Canada should assess the extent to which regions are represented by existing national parks and ensure that, where appropriate, park management plans address the need to improve representation.

Department's response: Agreed. The federal government's current priorities are the establishment of new national parks in unrepresented natural regions and creation of new national marine conservation areas.

Lack of clear objectives and priorities for completing the National Marine Conservation Areas System

31.75 Parks Canada released its first National Marine Conservation Areas System Plan in 1995. The Plan divides Canada's three oceans and the Great Lakes into 29 distinct marine regions. The goal is to represent each natural marine region in the system of national marine conservation areas. To date, there are four national marine conservation areas,

Fathom Five and a marine component of Pacific Rim National Park Reserve. In addition, federal-provincial agreements have been signed to create the Gwaii Haanas National Marine Conservation Area in the Queen Charlotte Islands of British Columbia (1988) and Saguenay Marine Park in Quebec (1990).

31.76 Parks Canada has neither developed an action plan nor established a target date for completing the National Marine Conservation Areas System. For example, the year 2010 has been recommended as one target date by the Canadian Environmental Advisory Council and the Endangered Spaces Campaign.

31.77 Studies to identify possible sites have been completed in 12 marine regions and feasibility studies are under active discussion in another three. But Parks Canada has not assigned priorities for carrying out work in each of the 29 regions. Potential biological and economic disruptions underline the need to protect our marine resources as a priority.

31.78 Parks Canada should develop a strategic plan, including a target date, for completing the national marine conservation area system.

Department's response: Parks Canada intends to prepare an action plan for establishing National Marine Conservation Areas (NMCA). Until further experience has been gained in establishing and managing national marine conservation areas, it would be premature and unrealistic to set a target date for completing the national marine conservation area system. Consultations on appropriate NMCA legislation have been authorized very recently.

The process for adding new parks is cumbersome

31.79 Parks Canada can add new national parks and national marine

Parks Canada has not developed an action plan for completing the National Marine Conservation Areas.

The 1994 State of the Parks report did not provide a complete and reliable assessment of the ecological condition of national parks.

conservation areas to the *National Parks Act* only if new legislation is passed. This requirement has become an impediment to bringing new national parklands into the system. For example, Aulavik National Park, created almost five years ago in 1992, will not be protected under the Act until Parliament amends it. Similarly, Parks Canada cannot add lands to existing national parks without returning to Parliament. However, the fact that existing national parks cannot be deleted or reduced in size without Parliament's approval does ensure that such areas are retained for the benefit of future generations. Parks Canada realizes that the present legislative process is cumbersome and is studying options to streamline the process.

31.80 Parks Canada should continue to seek amendments to the *National Parks Act* that would allow the federal government to add new national parks or enlarge existing ones through a streamlined legislative process, without having to introduce legislation in Parliament.

Department's response: Agreed. We underline though, that legislation is currently required.

Accountability to Parliament

31.81 The 1988 *National Parks Act* requires Parks Canada to report to Parliament on the state of the ecological conditions in national parks, and on progress made toward establishing new national parks. This information is to be reported at least once every two years through the State of the Parks report. The Act also requires the Minister to review each park's management plan once every five years.

31.82 The first State of the Parks report was tabled in 1990, and the next one was

published in 1994. Parks Canada did not meet its statutory requirement to table a Report in 1992. It is proposing amendments to the *National Parks Act* to change the reporting requirement from every two years to at least every five years. While we recognize that this is a legislative issue, we are worried that increasing the time interval between reports by too much would dilute Parks Canada's accountability to Parliament.

31.83 Parks Canada should table a State of the Parks report in Parliament within the time requirement stated in the *National Parks Act*.

Department's response: Agreed. Should Parliament agree to changing the cycle to align the State of the Parks report with the Sustainable Development Strategy reports, Parks Canada would adopt that cycle.

Improvements to the State of the Parks report are needed

31.84 In our 1989 audit of Parks Canada, we indicated the lack of reliable program performance information for management and Parliament. In our current audit we found that the problem persists, and that the 1994 State of the Parks report did not provide a complete and reliable assessment of the ecological condition of national parks, based on a national set of ecological integrity indicators.

31.85 The primary tool used to assess the state of ecosystems for the 1994 State of the Parks report was a questionnaire on 29 predetermined "stresses" (causes of impairment) affecting national parks. Stresses were, for example, visitor and tourism facilities and forestry operations occurring near parks. However, this approach fails to provide certain key information needed to draw fair conclusions about the ecological conditions in national parks. For example:

- it does not indicate the extent of impairment of the natural resources and processes in the parks; and

- it does not indicate how particular stresses affect the natural resources.

31.86 The 1994 State of the Parks report also provided information on the status of the national park system and ongoing work in some of the unrepresented natural regions. The benchmark for measuring progress in completing the system is a map of the 39 natural regions. The map indicates which regions are represented and which are not (Exhibit 31.3). It also includes a bar graph indicating progress in carrying out the five steps required to achieve a new national park (Exhibit 31.4, page 31–16).

31.87 We found that parliamentarians do not have enough information to assess Parks Canada's progress in establishing new parks because the 1994 State of the Parks report omits certain information and includes other information that is incomplete. We also found that the report overstated progress in several national parks and national marine conservation areas. For example, the report stated that Parks Canada had acquired all of the land for Grasslands and Bruce Peninsula. However, we noted that this information was incorrect and that the land acquisition programs for both national parks remain incomplete.

31.88 We also found that the 1994 State of the Parks report does provide some sense of progress toward completing the various steps, but it does not estimate the time that will be needed to progress to the next step. For example, the step involving the negotiation of an agreement appears to take a long time — years in many cases. Furthermore, the State of the Parks report does not clearly indicate:

- priority sites for work;

- whether any proposal is inactive; and
- information on the challenges facing Parks Canada in all of the natural regions.

31.89 We also noted that the 1994 State of the Parks report did not report on the status of planning in each of the 29 marine regions. The System Plan therefore remains the sole source of information on national marine conservation areas. Finally, the State of the Parks report provides little information on the likelihood that Parks Canada will meet its goal of completing the national park system by the year 2000.

31.90 Parks Canada should improve the quality of information in the State of the Parks report. The report should provide information that is complete and reliable enough to present a fair picture of the ecological integrity of national parks and the progress achieved in completing the system. It should also include information on the status of the national marine conservation areas.

Department's response: Agreed. Work in this area is already under way.

Overall departmental response: The Department of Canadian Heritage is pleased to note the Auditor General's support for refining and improving our programs in support of ecological integrity. The need for better science, improved technology and growth in knowledge are challenges that face not only this generation but future generations of park managers. The Auditor General's findings are consistent with the foundations that we have already built into the 1994 State of the Parks (SOP) report.

The Auditor General has suggested means to improve the State of the Parks report as an accountability instrument. The Department supports this and, as scientific knowledge and data become available, we will implement improvements. The SOP

The 1994 State of the Parks report omits certain information and includes other information that is incomplete.

report could, if Parliament agrees, be aligned with the new three-year reporting cycle for the Sustainable Development Strategy. As much of the data will be identical, this would avoid duplication, overlap and waste.

Parks Canada works hard to develop and communicate clear priorities for establishing new national parks in unrepresented natural regions. Every one of our partners, be they provincial governments, Aboriginal peoples, or non-governmental organizations, are aware of our priorities and kept up-to-date on their status. The audit does not give adequate recognition to the progress that has been made in establishing new national parks and protecting lands for proposed national parks. Recent progress includes: the acquisition of lands for a new national park in the Gulf Islands; the establishment of Wapusk and Tuk Tuk Nogait; land withdrawals for Wager Bay and Bathurst Island; and progress toward federal-provincial agreements on the Interlake area in Manitoba and the Torngat Mountains in Labrador. These results reflect the effort of many years of focussed, prioritized work. In the last six months the federal government has protected, through two new park establishment agreements and through land withdrawals, more than 60,000 square kilometres of land — an area larger than the province of Nova Scotia.

Parks Canada continues to work with other jurisdictions and federal departments to utilize their legislative powers to withdraw park sites from development. In the last two years successful land withdrawals have been accomplished for three areas in the Northwest Territories by Indian and Northern Affairs Canada and one in Manitoba (Wapusk) in response to Parks Canada initiatives.

The Auditor General suggest that Parks Canada pursue alternatives that would permit natural regions to be represented by something other than a national park. The Department follows explicit government direction in its goal to complete the system, based on establishing national parks owned by all Canadians and managed on behalf of all Canadians. Parks Canada will continue in this direction.

Parks Canada intends to prepare an action plan for establishing national marine conservation areas (NMCA). On October 14, 1996, the Prime Minister announced the start of federal/provincial/public consultations aimed at introducing an NMCA Act in Parliament during 1997. It is considered premature to set a target date for completing the national marine conservation area system. We maintain that our current goal of establishing six areas by the year 2000 is realistic and attainable.



About the Audit

Objective

The objective of our audit was to review and assess whether Parks Canada is effectively managing two components of the program for which it is accountable—protection of ecological integrity and new park establishment—and to make recommendations to the Department.

Scope

Our audit focussed on the systems and processes Parks Canada has in place to maintain, enhance and report on ecological integrity; and to complete the national parks systems.

Criteria

Natural Heritage Protection (Ecological Integrity)

National parks should be maintained and used so as to leave them unimpaired.

The Department of Canadian Heritage should have and provide to Parliament relevant, reliable and timely information on the state of the natural heritage within national parks.

The Department of Canadian Heritage should have developed ways to measure the effectiveness of protective measures put in place.

New Park Establishment

The establishment of new national parks should be based primarily on their natural relevance and take into account opportunities to enhance Canadians' understanding and enjoyment of their natural heritage and the future operating costs to the government.

The Department of Canadian Heritage should have and provide to Parliament adequate information on the completion of the park system.

The establishment of new parks should be pursued with due regard to economy and efficiency.

Approach

The ecological integrity review focussed on a sample of six national parks (see Exhibit 31.2) out of the 36 established ones, including one park in each administrative region. The two newly established parks were excluded from our sample. The sample was selected to reflect as wide a diversity of Parks Canada's activities and management conditions as possible. The audit included the review of various Parks Canada documentation, and interviews at headquarters, regional and district offices. A survey on key ecological integrity issues was sent to the 36 national parks. We also met with stakeholders to understand their needs in regard to Parks Canada activities.

We examined documentation on progress and activities in establishing new parks, and met with staff who are directly involved in new park establishment at headquarters and the regions. We also reviewed documentation on three proposed national parks, including sites in southern Canada, the near north and northern Canada. We selected a successful national park, one still being negotiated and one where attempts to date have failed to produce a national park.

We consulted with the Department's Corporate Review Branch on all aspects of the audit. As the Branch had not yet started on an examination of either the protection of ecological integrity in national parks or new park establishment, it could not supply additional data.

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Chapter 32

**Canadian Heritage – Parks Canada:
Management of Historic Canals**

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants.

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Canadian Heritage – Parks Canada: Management of Historic Canals

Assistant Auditor General: Robert R. Lalonde

Responsible Auditor: Harry A. Ruthnum

Main Points

32.1 In recognition of the change from commercial transportation to recreational activities and historic appreciation, the nine historic canals were transferred in the 1970s to Parks Canada. At that time, the government decided that “there should be a shift in emphasis in the management of the canal systems from transportation to historic restoration, preservation and interpretation; natural environment preservation and interpretation and optimum use of federal lands.”

32.2 There is a significant gap between canal revenue and total operating costs. A number of studies have pointed to the need for restructuring and closing that gap; however, little progress has been achieved. Our audit noted that services do not reflect user demand, canals are not restored or operated in the least costly manner, and there has been a lack of success in finding partners to take over canal responsibilities or contribute to their financing.

32.3 Taxpayers are paying the major portion of expenses incurred by Parks Canada to provide a private benefit to boaters. Canal management has stated that it has no intention of increasing boater revenue such that it covers navigation costs, and that it is not possible to do so.

32.4 Navigation serves a very limited and declining market. In a typical year, no more than 1,370 and 2,200 boats navigate the entire Trent–Severn Waterway and Rideau Canal respectively. Although the canals operate for five months, 80 percent of boaters use them during July and August only. Shortening the navigation season would reduce operating costs by approximately 45 percent. In addition, combining a shorter season with the closing of underutilized locks could result in savings of close to \$10 million annually.

32.5 Over the years, the Department of Justice has provided legal opinions on various aspects of the requirement for Parks Canada to provide for navigation. In June 1996, advice was offered which touched on another aspect of the issue. In our view, these opinions do not provide enough guidance on Parks Canada’s obligation to provide for navigation. In light of new fiscal realities, Parks Canada’s obligation with respect to the requirement to provide for navigation needs to be reviewed.

32.6 Parks Canada is seeking authorization from the Treasury Board to reconstruct a recreational lock at Sault Ste. Marie, in partnership with the Province of Ontario and the City of Sault Ste. Marie. Capital costs are estimated at \$28 million over a 30-year period. If a rigorous business case analysis had been performed, continued operation of the historic site and permanent closing of the lock would clearly be the most cost-effective option.

Introduction

32.7 Parks Canada is responsible for nine historic canals: the Rideau, Trent–Severn Waterway and Sault Ste. Marie canals in Ontario; the Carillon, Ste. Anne de Bellevue, Lachine, Chambly and St. Ours canals in Quebec; and St. Peters Canal in Nova Scotia (Exhibit 32.1). These canals, constructed throughout the 1800s, provided vital trade and transportation links as well as the free movement of military troops and supplies in the event of war. They vary from those with single locks, such as the St. Peters Canal, to complex systems of channels

and natural waterways, such as the Rideau Canal and Trent–Severn Waterway. The canals contributed to regional trade for several decades, but commercial traffic began to decline shortly after their completion with the introduction of the railways in the 1850s.

32.8 Today, the historic canals are used primarily by pleasure boats. Visitors along the canals use the sites as park land, for picnicking, walking, observation and fishing. In addition to the canals, dams and locks, there are many elements of historical interest, such as lockmasters' houses, blockhouses, powerhouses and

Exhibit 32.1

Historic Canals of Canada



Source: Parks Canada

In recognition of the change from commercial transportation to recreational activities and historic appreciation, the historic canals were transferred to Parks Canada.

machinery. Different periods of canal history are illustrated by means of interpretive exhibits.

32.9 In recognition of the change from commercial transportation to recreational activities and historic appreciation, the historic canals were transferred to the Minister responsible for Parks Canada in the 1970s. All of the canals except two were transferred to Parks Canada from the Department of Transport in 1972. The Lachine Canal was transferred from Public Works in 1978 and the Sault Ste. Marie Canal was transferred from the St. Lawrence Seaway Authority in 1979.

32.10 Parks Canada's management of the historic canals falls under two distinct, yet complementary, mandates: government decisions directing the transfer of the canals to the Department of Indian and Northern Affairs, and sections 16 and 17 of the *Department of Transport Act* and the Historic Canal Regulations made pursuant to that Act; and decisions pursuant to the *Historic Sites and Monuments Act*, which provide for "the administration, preservation and maintenance" of national historic sites.

32.11 Parks Canada's mandate for the management of national historic sites derives from the *Historic Sites and Monuments Act*. Under this Act, national historic significance is recommended by the Historic Sites and Monuments Board, an independent body that provides advice to the Minister. With respect to the canals, the Board has recommended commemoration by plaque only or commemoration by plaque with a further commitment to preservation and presentation. The Minister may accept or reject Board recommendations.

32.12 All of the canals have been designated as having national historic significance as waterways that are part of

Canada's National Canal System. The Minister approved commemoration by means of a plaque for all of the canals but decided that only the Rideau and a portion of the Trent–Severn warranted preservation.

32.13 In November 1987, the Historic Sites and Monuments Board recommended that the Rideau Canal be established as a national historic park, or, failing that, be managed as such. This was approved by the Minister.

32.14 In addition, specific canal structures have been individually designated as worthy of commemoration and preservation due to their architectural significance. These include the Peterborough Lift Lock of the Trent–Severn and the emergency swing dam of the Sault Ste. Marie Canal.

32.15 All except the Lachine and Sault Ste. Marie canals are operating for through navigation. In 1959, the opening of the St. Lawrence Seaway meant the end of transit navigation in the Lachine Canal. Both ends of the canal have been filled in and recreational use of the water is prohibited due to contamination. The Sault Ste. Marie Canal was closed in the summer of 1987 due to a stability problem with the lock wall.

32.16 Government decisions in the early 1970s provided direction to Parks Canada on the management of the transferred canals. In July 1971, with respect to the transfer of the Rideau and Trent–Severn canals, the government directed that "the transfer be undertaken with the clear understanding that the canal systems be maintained and operated with special regard to their important historical values." In February 1972, the government decided that "there should be a shift in emphasis in the management of the canal systems from transportation to historic restoration, preservation and

interpretation; natural environment preservation and interpretation and optimum use of federal lands.” A plan for the optimum recreational development of the Rideau–Trent–Severn Waterway corridor was also adopted.

32.17 Both the Lachine and the Sault Ste. Marie canals were transferred to Parks Canada with specific mandates distinct from the 1972 decision. With the transfer of the non-operating Lachine Canal in 1978, Parks Canada was to take on, among its other objectives, responsibility for urban and near-urban park development. When the Sault Ste. Marie Canal was transferred in 1979, a government decision directed that it be developed as a heritage park and that lock operation be reduced due to a decline in commercial shipping.

32.18 To date, neither the provinces nor local municipalities have made any financial contribution to defray canal costs, although recreational development is a provincial responsibility. Economic analysis indicates that direct visitor and government expenditures add more than \$44 million annually to provincial gross domestic product.

32.19 At the time of the canals’ transfer, the Parks program was delivered by the Department of Indian Affairs and Northern Development. In 1979, the program was transferred to the Department of the Environment, along with the historic canals. Then, in June 1993, the program was amalgamated with the new Department of Canadian Heritage. In the 1996 Budget, it was announced that Parks Canada would become a separate service agency. Legislation to create the agency is being drafted.

32.20 Distinct from the creation of the agency, Parks Canada is considering

employee takeovers and increased contracting-out of work, where this would generate savings and improve efficiency. Treasury Board’s Employee Takeover Policy sets out the government-wide position with respect to employee takeovers in general. The Department of Canadian Heritage has recently been declared a Most Affected Department. To be designated as such, a department needs to demonstrate to the Treasury Board that it will not be able to meet expenditure reductions using attrition or existing tools that emphasize the placement of surplus personnel. If implemented, these changes may provide Parks Canada with greater flexibility in the way canal services are delivered.

32.21 Total operating expenses of the nine canals amount to approximately \$24 million annually; capital costs average \$11.5 million annually. In addition to providing navigation services and preservation of canal structures, Parks Canada provides a number of other services in connection with the canals. These include water control, wetland and wildlife conservation, realty rights and privileges, interpretation and recreational services. However, a significant proportion of canal resources is spent in providing for navigation and in maintaining canal structures. Operations and maintenance expenses for the Rideau and Trent–Severn comprised 76 percent of their total operating expenses in 1994–95 (Exhibit 32.2).

32.22 Canal expenses quoted in the chapter exclude costs relating to specialized services, such as archaeology, historical resource conservation, cultural resource management, advisory and business management, and historical research, as well as administrative overhead costs. These costs relate to the operations of headquarters and the

Neither the provinces nor local municipalities have made any financial contribution to defray canal costs.

Cornwall District Office, and are not allocated by Parks Canada as overheads to canal expenses.

Focus of the audit

32.23 Our audit objective was to assess whether Parks Canada is managing the canals in an efficient and cost-effective manner, given its mandate and priorities. Further details on the audit objective, scope, criteria and approach are found at the end of the chapter in the section **About the Audit**.

Observations and Recommendations

Need for a Different Approach

Slow progress toward change

32.24 During the last 11 years, the canals have been subject to a number of reviews to identify opportunities for

streamlining and savings. These reviews are presented in Exhibit 32.3.

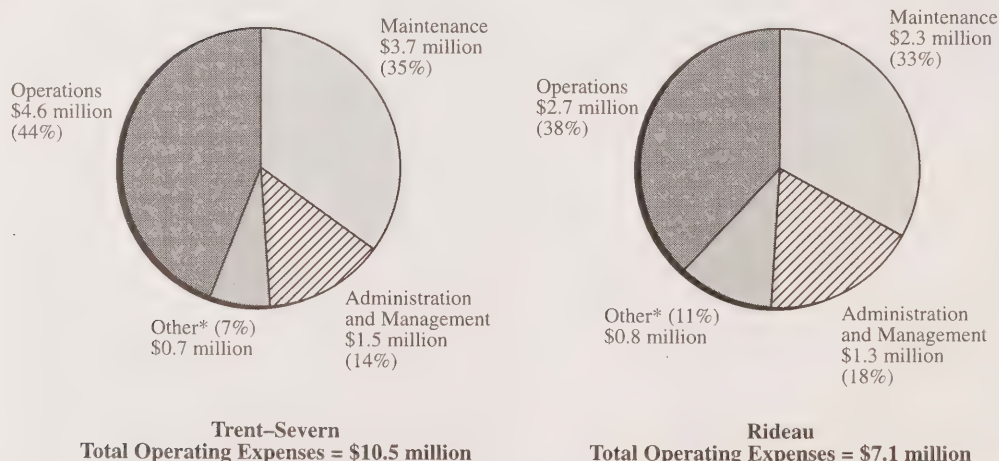
32.25 The report resulting from the *Nielsen Task Force on Program Review* recommended increasing canal revenues to cover operations and maintenance costs over a five-year period; approaching the provinces and municipalities for a contribution to operating costs; changing the Sault Ste. Marie Canal to non-operating status; and more extensive contracting-out of maintenance operations. Except for negotiations with the provinces, which were unsuccessful, these recommendations were largely ignored.

32.26 The *Heritage Canals Task Force Report* reviewed Parks Canada's mandate, legislation, policies and functions relating to heritage canals. It noted that navigation consumed the major part of both capital and operating resources, followed by preservation, while interpretation and recreation received the lowest level of resources. The report considered options for reducing canal operations. Its

The Heritage Canals Task Force noted that navigation consumed the major part of both capital and operating resources.

Exhibit 32.2

Operating Expenses, 1994-95



* Other includes Resource Conservation, Realty, Visitor Activities

Source: Derived from Parks Canada reports

recommendations focussed on ownership of the canals, the need to increase revenue and the canal's share of parliamentary funding, and the need to transfer the Lachine Canal to another agency or government.

32.27 The 1993 *Operational Reviews* of the Rideau Canal and Trent–Severn Waterway were conducted in response to a management proposal that the canals reduce their service to better reflect levels of use. That proposal would have resulted in a significant reduction in the hours of work for operating staff and in the level of service to the public. At that time, the Program Management Committee agreed to fund the Ontario Region's shortfall for the 1993–94 fiscal year, but expected the study to identify ways to reduce total operating costs by 30 percent and increase revenue from \$2 million to \$5 million, commencing in 1994–95. The National Operational Review included preliminary analysis with respect to reducing canal services, although no effort was made to accurately calculate savings. The review concluded that the canals should continue to operate as navigation systems, while recognizing that the costs of operation far outweigh the revenues received. It was

recommended that Parks Canada commence negotiations with the Treasury Board on revenue retention and status as a special operating agency.

32.28 In 1994, an independent, external Canals Review Team was established. In its 1995 report *Corridors of Change*, the Team recommended increasing revenues through a number of activities and decreasing costs through reorganization and better use of lock operator time. This report contributed to the consolidation and realignment of canal functions and the pursuit of a variety of revenue sources. After two decades of stable staffing levels, the number of employees on the Rideau Canal and Trent–Severn Waterway has been reduced by 16 percent, from 373 in 1993–94 to 312 in 1995–96.

32.29 The Canals Review Team noted, "Operating costs are too high for the number of boaters served during significant parts of the year, mainly in the shoulder season, and in certain underutilized parts of the canals. The canals can no longer afford the luxury of current staffing levels and practices." The Team commented, "The federal government and Parks Canada policies are very clear. Where services are provided

Date	Title	Purpose
1985	Nielsen Task Force on Program Review	To provide better service to the public and improve management of government programs
1987	Heritage Canals Task Force Report	To respond to the report of the Nielsen Task Force and to review ownership of the canals, the need for additional parliamentary funding, the provision of service and organizational restructuring for better management
1993	Operational Review No. 30 – Canals (A national review followed by individual reviews for the Rideau Canal and Trent–Severn Waterway)	To respond to a proposal that the canals reduce their service to better reflect usage; to identify opportunities for streamlining and savings in order to meet expected budget shortfalls
1995	Rideau and Trent–Severn Historic Canals: <i>Corridors of Change</i>	To review hours of operation and non-boating fees; to identify efficiencies to meet budget reductions and to identify new sources of revenue

Exhibit 32.3

Canal Reviews

The canals have made little progress in closing the gap between revenue and total operating costs.

primarily for personal benefit, the cost must be recovered through user fees. Marine fees very clearly fall under this user-pay policy.” Despite these findings, the *Corridors of Change* report recommended the continuation of canal hours of service for the next five years, “in order to provide stabilized hours of operation and to support tourism marketing initiatives.”

32.30 While the studies pointed to the need for restructuring and closing the gap between total operating costs and revenue, no fundamental change in canal services has been implemented. Maintaining the status quo in terms of services has resulted in revenues covering only a small percentage of costs, services that do not reflect user demand, canals that are not restored or operated in the least costly manner, and a lack of success in finding partners to take over canal responsibilities or contribute to their financing. In addition, we noted that neither the canal

management plans nor the Central and Eastern District Business Plan offer any substantial change to the current way of operating.

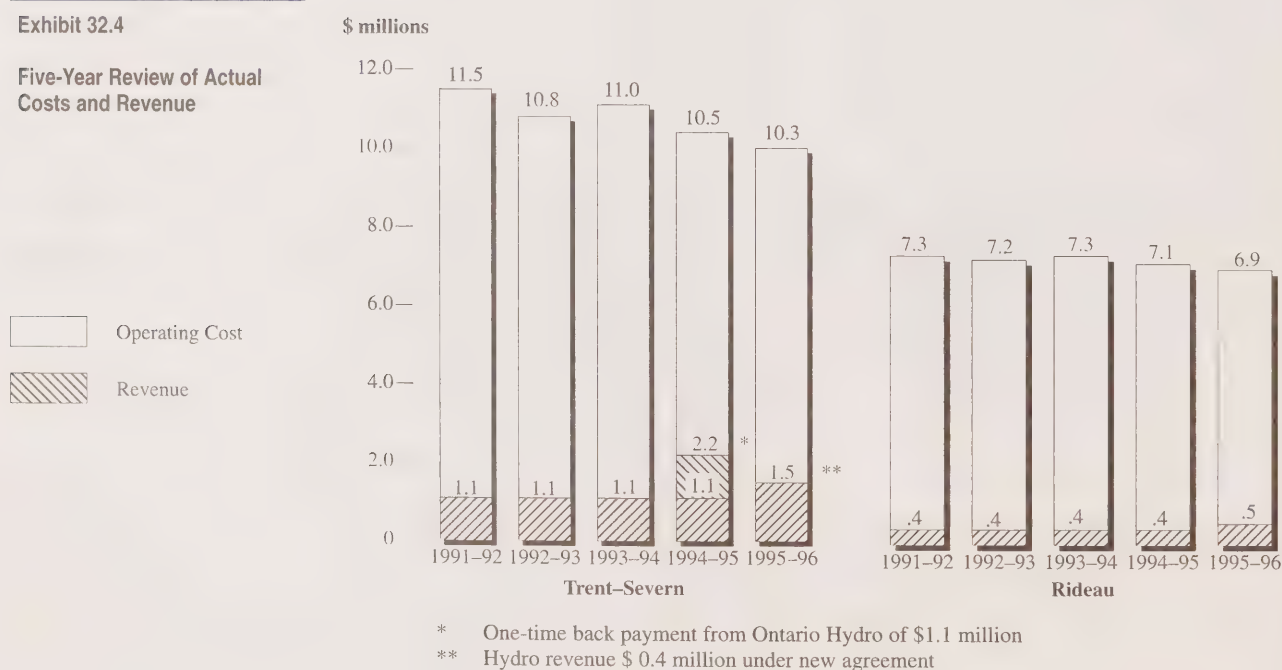
Significant gap between revenue and total operating costs

32.31 The canals have made little progress in closing the gap between revenue and total operating costs (Exhibit 32.4). In 1994–95, revenue for the Rideau and Trent–Severn (excluding a back payment for hydro-electricity generation) covered 8.9 percent of total operating costs and 9.2 percent for all canals. By comparison, nearly a decade earlier in 1985–86, revenue covered 7.7 percent of total operating costs for the Rideau and Trent–Severn, and 9.5 percent for all canals.

32.32 In 1995, Parks Canada management directed the two canals (Rideau and Trent–Severn) to achieve a 20 percent reduction in total operating budgets over a three-year period, from

Exhibit 32.4

Five-Year Review of Actual Costs and Revenue



Note: Excludes overhead costs relating to Headquarters and the Cornwall District Office

1995–96 to 1997–98. This reduction represents \$1.2 million for the Rideau and \$2 million for the Trent–Severn. In addition, revenue is to increase by approximately two and a half times, from \$2 million to \$4.8 million, over the same period.

32.33 The canals have requested an extension of the three-year timeframe to increase revenues. As a result, the period has been increased to four years. Even with the extended timeframe, the Rideau and Trent–Severn expect a significant gap between actual and projected revenue. Total projected revenues show an increase from \$2 million in 1995–96 to \$3.4 million in 1998–99 (Exhibit 32.5).

32.34 Actual revenue for 1995–96 amounted to \$2 million, with the Rideau Canal generating \$0.5 million and the Trent–Severn \$1.5 million. The revenue increase from previous years is almost entirely due to a renegotiated hydro-electricity agreement on the Trent–Severn. As a result of this

agreement, hydro-electricity revenue will remain constant over the long term.

32.35 Total operating expenses for the Rideau Canal declined by \$0.27 million or four percent in 1995–96, and by \$0.15 million or one percent for the Trent–Severn. Even with a 20 percent reduction, total operating expenses for the two canals will still be over \$14 million annually.

32.36 Parks Canada should re-examine its options and develop a realistic strategy and action plan that will lead the organization toward reducing costs and increasing revenues across the entire canal system.

Department's response: Parks Canada is implementing significant cost reductions across the canal system. Some costs are due to the restoration and preservation of Historic Canals for the benefit of all Canadians, and are appropriately funded through general government revenues. No feasible way has yet been identified to derive revenue to offset other costs, from all those who enjoy the many benefits

\$ millions

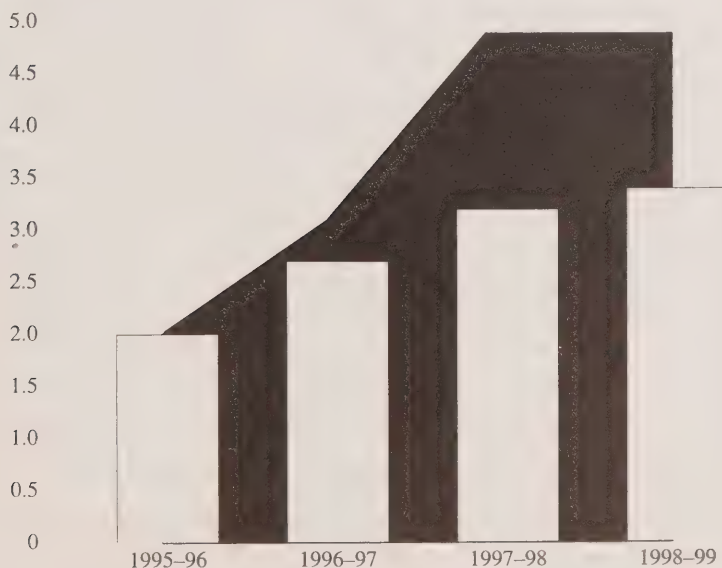


Exhibit 32.5

Rideau and Trent–Severn Projected
Total Revenue versus Target

Target ■
Projected Revenue □

Source: 1996 Revenue Strategy

Taxpayers are paying the major portion of expenses to provide a private benefit to boaters.

associated with recreational activities and water management.

Boaters pay only a small fraction of the cost of canal services

32.37 All of the canal studies indicate that lockage fees paid by boaters fall well short of the costs of operating the locks. Based on lockage and mooring revenue and the reported number of vessels, boaters paid an average of \$3.48 per lockage in the 1995 season compared with \$2.75 in 1988. Revenue from boaters covered only five percent of total operating costs in 1995–96.

32.38 The situation is not improving. Over the past eight years, total lockage and mooring revenues have declined by one percent, and there has been a 6.5 percent decline since the 1990 season, when revenues from boaters peaked. The decline in revenues is primarily due to a reduction in the number of boaters (Exhibit 32.6). This declining trend has continued in the 1996 navigation season. Results for the first four months show a decline of 8 percent in the number of boats for the Rideau Canal and 13 percent for the Trent–Severn Waterway.

32.39 Should the decline continue, even with fee increases, boater revenue is likely to cover an even smaller portion of navigation costs. It was reported in the 1995 *Corridors of Change* report that there is a strong feeling among many boaters that they must shoulder an unfair share of canal operating costs. This same report emphasized that “boaters pay only a small fraction of canal services.” This has been a long-standing dilemma for Parks Canada. If lockage fees are increased, then the number of recreational boaters may decline, calling into question the need for an operating canal system. Parks Canada has not developed a solution for dealing with this important issue.

32.40 Taxpayers are paying the major portion of expenses incurred by Parks Canada to provide a private benefit to boaters using the Rideau and Trent–Severn systems. The fact that boaters pay considerably less than their fair share of costs contributes significantly to the revenue gap. Canal management has indicated that it has no intention of bridging the gap between navigation costs and revenues and that it is not possible to do so.

32.41 Parks Canada should rethink its provision of navigation services, in order to ensure that its services are relevant, affordable and responsive to the changing needs of Canadians.

32.42 Parks Canada should develop a strategy to deal with the potential situation of increased lockage fees and declining numbers of recreational boaters. It should ensure that revenue from navigation more closely approximates navigation costs, in accordance with directives of the Treasury Board.

Department's response: Navigation is only one of a number of services provided for under Parks Canada's mandate for the Historic Canals. Boaters should pay an equitable portion of the cost of canal services in line with the application of the government's user pay principle. Fees from boaters should not exceed their fair share of costs. Research for the purpose of allocating costs between water-based and land-based users and between those who benefit by being on the canal and those who benefit from water management are complex and expensive. Such data would only be of use if these benefits and their costs could be linked to a feasible collection system.

Constraints to achieving savings

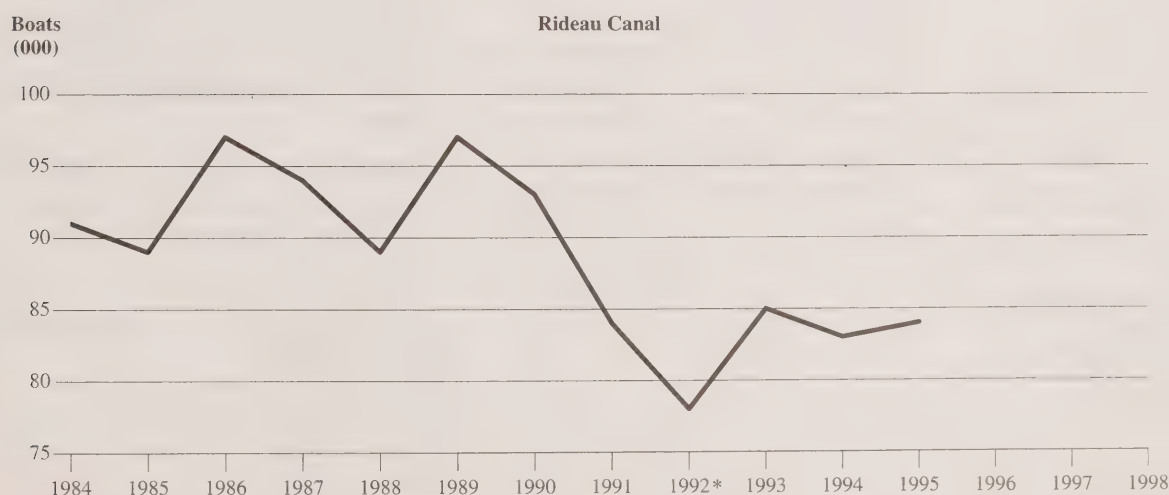
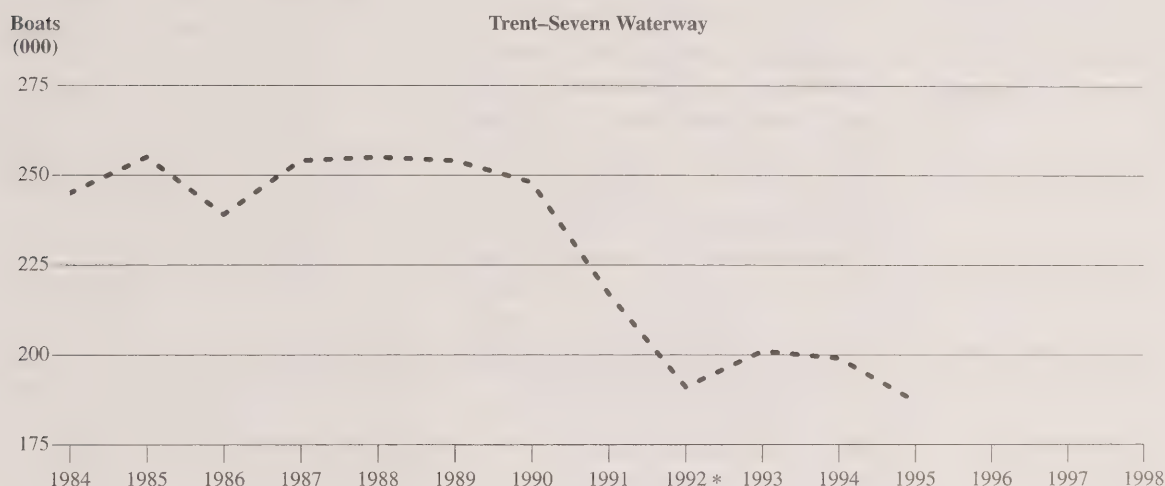
32.43 Salaries make up the largest portion of the Rideau Canal and

Trent–Severn Waterway budgets. Employees who work a full year require 2,080 working hours. Lockmasters and lock operators have traditionally worked the majority of these hours during the five-month navigation season. This has resulted in staff working longer hours than required by boater demand, particularly in

the fall and spring shoulder seasons. It has also resulted in maintenance/water management assignments, subsequent to the navigation season, designed to enable employees to work the full 2,080 hours. However, there are numerous maintenance staff on both systems, and specific water management staff on the Trent–Severn

Exhibit 32.6

Number of Boats through Locks by Year



Lockage fee increases occurred in 1985, 1987, 1990 and 1991

*Wet, cool summer in 1992

Source: Derived from Parks Canada reports

Waterway, where most water management occurs.

32.44 In an attempt to achieve the savings required in operating costs, management delayed the callback of some lock operators in the spring of 1995 and 1996, reduced the hours of operation by one to two hours per day, and reduced the number of personnel used in water control. As a result, a number of lock operators have become seasonal employees. Grievances were received on both canals, challenging the employer's right to change the tenure of employees from full-time to seasonal status. The employees also grieved that this change in hours constituted a work force adjustment situation and, as such, the employer should have provided the affected employees with the entitlements provided by the Work Force Adjustment Directive. If the affected employees are successful in their grievance, the projected cost savings will not be realized this year.

32.45 The canals also proposed operating most lock stations with one person in the spring and fall shoulder seasons. However, the Canada Occupational Safety and Health Regulations, which fall under the Canada Labour Code, require that where a worker is exposed to a hazard of drowning in the workplace, another person be made available to operate all the emergency equipment. The canals have partially offset this decision by using crews that serve more than one lock station in the shoulder seasons, where locks are in sufficiently close proximity.

32.46 The above interpretation of the Canada Labour Code has limited the ability of Parks Canada to take advantage of other potential savings. For example, we noted that many of the Trent–Severn locks are mechanized, with lock gates operated by means of push buttons.

However, two staff members are still required to operate each lock. While accident records lack detail on the causes and seriousness of accidents, management has indicated that no serious accident has occurred to staff due to operating the locks. In addition, the original Rideau–Trent–Severn Waterway Corridor report indicated that power assists could be applied to the traditional Rideau Canal locking mechanisms. This would allow one staff member to operate each lock. The option has not been investigated, even for locations where there is virtually no historic fabric remaining.

32.47 It is expected that further revenue generation and/or expense reductions will be required of the canals beyond those already set out, as indicated in a memo issued to all staff in May 1996. With declining parliamentary appropriations, greater progress is needed in reducing total operating costs. Labour management is perhaps the most critical element to the future success of the canals, and has a direct impact on options for the future.

32.48 In its negotiation of labour agreements, Parks Canada should strive for greater flexibility in staffing arrangements to help ensure the long-term financial viability of the canals.

Department's response: Agreed. Parks Canada, as recognized by the auditors, will continue to search for innovative staffing arrangements.

Navigation services provided despite limited demand

32.49 Canals are currently open for navigation for five months, from mid-May to mid-October. Statistics indicate that there are fewer boaters using the locks in the months of May and October. In fact, the majority of boater needs could be met by operating the locks during July and

The majority of boater needs could be met by operating the locks during July and August only.

August only (Exhibit 32.7). Based on our analysis, operating costs would be reduced by an estimated \$4.7 million while still meeting the needs of 80 percent of the boaters.

32.50 Only a few of the lock stations are extensively used on the Rideau and Trent–Severn systems (Exhibit 32.8). A lock station may represent one lock with two staff members, or a flight of locks with a number of staff members. Boater data are compiled on a lock station basis, in order to avoid double counting boats as they pass through a flight of locks. As is illustrated by the graphs, in a typical year no more than 1,370 boats navigate the entire Trent–Severn Waterway, and no more than 2,200 boats navigate the entire Rideau Canal. Providing continuous through navigation therefore serves a very limited market.

32.51 Additional savings could be attained by closing the locks that boaters use infrequently. We have determined that 64 percent of the Rideau locks could be closed (30 out of 47 operating locks) and 55 percent of the Trent–Severn locks

could be closed (24 out of 44) while still meeting the needs of 71 percent of the boaters. We estimate that this measure would provide an annual saving of approximately \$7.7 million in operating, maintenance and administration costs.

Based on our analysis, combining a shorter season with the closing of underused locks could result in savings of close to \$10 million. There may be legal implications associated with closing the locks, as discussed in paragraph 32.58.

32.52 Exhibit 32.9 illustrates our estimate of potential savings based on Parks Canada's financial records. These records do not track actual costs per lock or lock station. Therefore, our calculations are based on an average cost per lock. To determine savings more precisely, Parks Canada would need improved costing information.

32.53 Our estimates are conservative. We have indicated that shortening the navigation season from five months to two months would reduce operating costs by 45 percent. This is to provide for water management activities and the longer hours worked in July and August. As

Providing continuous through navigation serves a very limited market.

Number of Boats Passing through Locks (000)

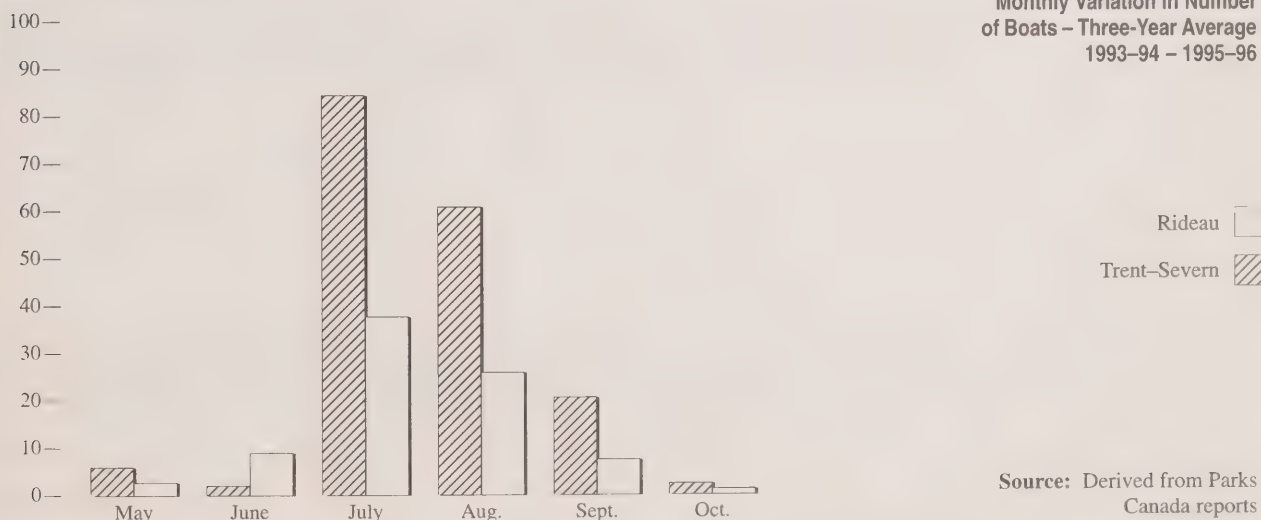


Exhibit 32.7

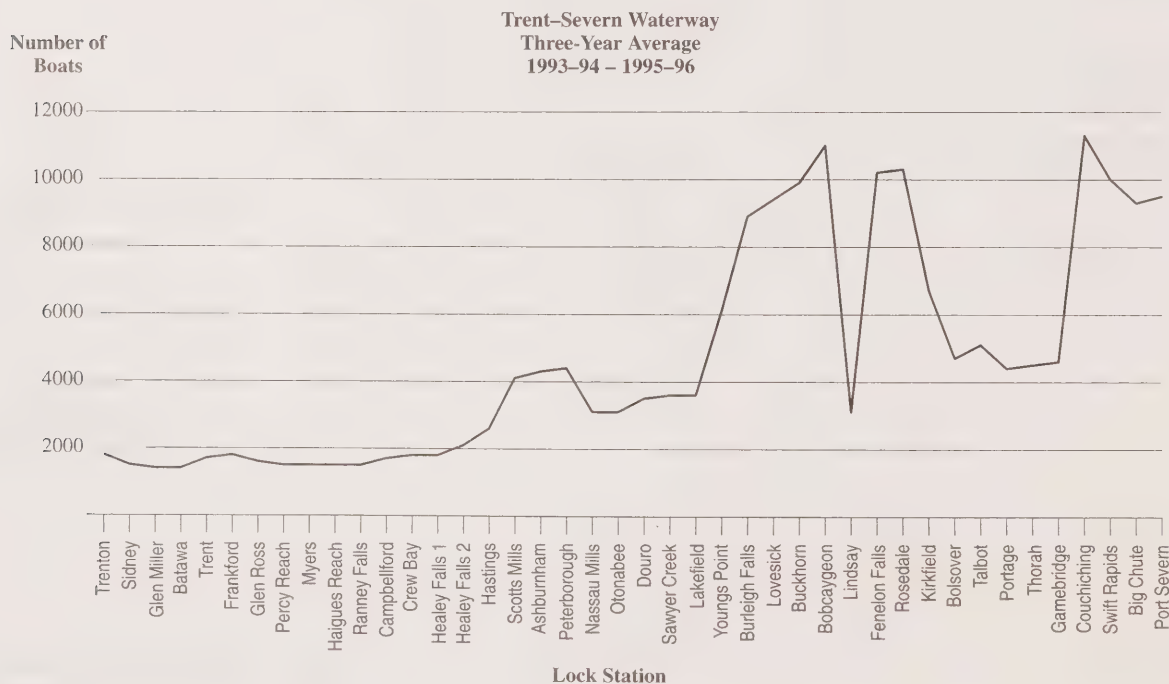
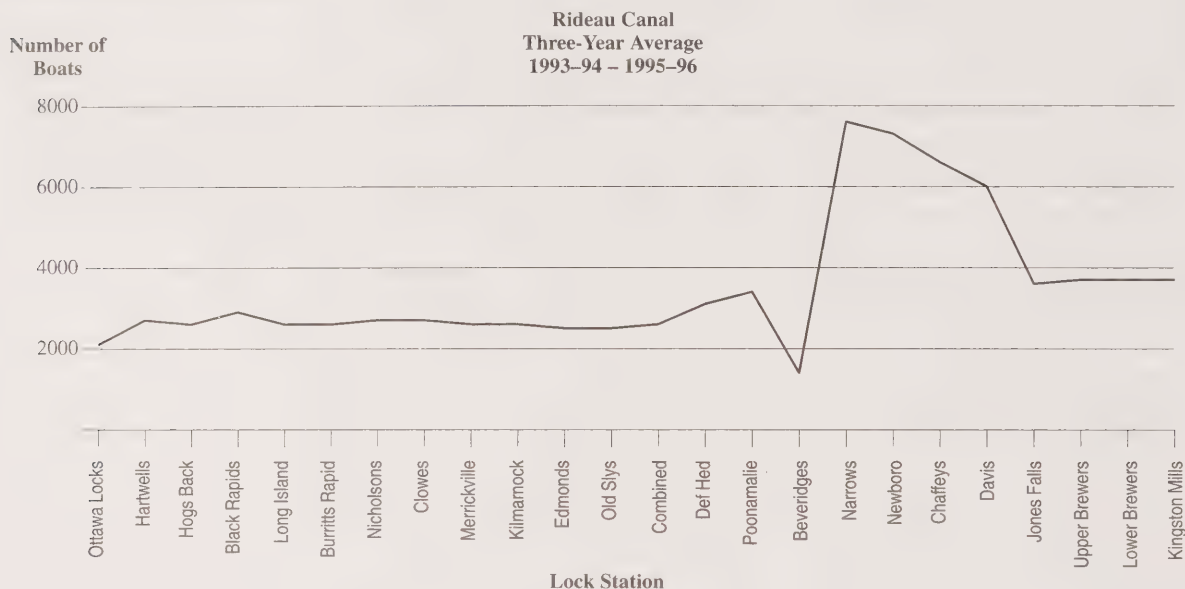
Monthly Variation in Number of Boats – Three-Year Average
1993–94 – 1995–96

Source: Derived from Parks Canada reports

indicated elsewhere, Parks Canada does not separately track the cost of water management for navigation versus flood control. Although capital savings would be realized, particularly in discontinuing

some lock operations, we have not provided an estimate due to the limited information available. It is not known to what extent capital and maintenance costs are incurred to provide for safe

Exhibit 32.8
Number of Boats by Lock Station



Source: Derived from Parks Canada reports

navigation, in addition to preservation of canal structures.

32.54 To operate within lower appropriation levels, Parks Canada should study options to streamline its activities by being more aware of its market. These options should include consideration of more innovative modes of operation and improved use of available technology where appropriate.

32.55 Where locks are underutilized, the provinces or municipalities could be provided with the option of contributing financially or assuming lock operation, with the alternative being closure of the lock in the event that no interest is expressed.

32.56 Costs relating to individual lock stations should be compiled, reported and used in making decisions with respect to canal operations.

Department's response: Parks Canada will continue to meet the legal requirement for the provision of through navigation on the Historic Canals in the most effective and efficient manner. Parks Canada is building demand through marketing, innovative operating procedures and partnership possibilities within the government's mandate.

Obligation to provide for navigation unclear

32.57 The issue has been raised of whether Parks Canada has a statutory obligation to maintain navigation along the Trent–Severn Waterway and Rideau

	Rideau	Trent–Severn	Total Potential Savings
Shorten Navigation Season – 45 percent reduction in costs			
Operations	\$1.3	\$2.1	\$3.4
Administration and Management	0.6	0.7	1.3
Maintenance			
Capital			
Total – Shorten Navigation Season			\$4.7
Discontinue Lock Operations – 64 percent of Rideau locks and 55 percent of Trent–Severn Locks			
Operations	1.8	2.5	4.3
Administration and Management	0.8	0.8	1.6
Maintenance (50 percent savings for closed locks)	0.8	1.0	1.8
Capital			
Total – Discontinue Lock Operations			\$7.7
Discontinue Lock Operations and Shorten Navigation Season			
Savings from discontinued lock operations			7.7
Savings from shorter navigation season, reduced by number of closed locks			2.0
Total Potential Savings			\$9.7

Exhibit 32.9

Potential Savings from
Reduced Levels of Service

(\$ millions)

In light of new fiscal realities, Parks Canada's obligation with respect to navigation needs to be reviewed.

Canal. When the canals were transferred from the Department of Transport, the legislation governing them was not changed. Therefore, the powers, responsibilities and functions of Parks Canada with respect to historic canals are included in sections 16 and 17 of the *Department of Transport Act*, and its associated Historic Canal Regulations.

32.58 Over the years, the Department of Justice has provided legal opinions on various aspects of the requirement for Parks Canada to provide for navigation. In June 1996, advice was offered which touched on another aspect of the issue. In our view, these opinions do not provide enough guidance on Parks Canada's obligation to provide for navigation. In light of new fiscal realities, Parks Canada's obligation with respect to the requirement to provide for navigation needs to be reviewed.

32.59 Parks Canada's current emphasis on navigation severely limits the ability of the canals to become financially viable. Without the requirement for navigation, the costs of operating and maintaining the canals would be significantly reduced. By closing parts of both canal systems, revenue from navigation would more closely approximate navigation costs, in line with Treasury Board policy on cost recovery. This could lead to greater interest on the part of other levels of government or private enterprise to assume responsibility for part or all of canal operations.

32.60 Parks Canada should:

- clarify its obligations with respect to navigation;
- establish clear priorities with respect to navigation, preservation of canal structures, historical presentation and natural resource conservation; and

- implement actions that reflect those priorities.

Department's response: Legal advice to Parks Canada has confirmed a legal obligation to provide for through navigation on the Rideau and Trent–Severn canals. Parks Canada has shared that advice with the auditors.

Planning to Meet the Future

Adequate information not available for establishing user fees

32.61 In March 1994, Parks Canada introduced a policy whereby user fees would shift the burden of paying the costs of government services from taxpayers to those who benefit most directly. This means that services that benefit the public in general should be funded from appropriations, but services that provide primarily personal benefits to individual users should be funded out of revenues collected for those services.

32.62 Parks Canada has targeted the realty rights and privileges area as the major source of future revenue growth. In addition, Parks Canada has significantly increased fees in this area, which includes hydro-electricity, over the past eight years (Exhibit 32.10). For 1996–97, proposed fee increases included:

- charging commercial waterlots a new annual rental fee of \$50 per vessel for their docking facilities (delayed for the 1996 season, pending further consultation);
- doubling the minimum annual rental fee for access lots;
- increasing dredge and fill permits by 40 percent for non-commercial operations, 185 percent for existing commercial operations, and 615 percent for new commercial operations;
- doubling the minimum annual rental fee for utility and cable crossings; and

- increasing the minimum fee for municipal sewer outfalls by 150 percent.

32.63 While significant fee increases are being implemented for realty rights and privileges, on a full cost-recovery or cost-recovery-plus basis, those who benefit most from an operating canal system, the boaters, faced a lockage fee increase of only 10 percent for 1995–96. It is not possible to make comparisons with the subsequent year, as the basis on which fees are determined has changed. This has resulted in some boaters paying more and others paying less, depending on length of boat and type of permit.

32.64 Accurately determining the cost of Parks Canada's services and their primary beneficiaries is vital in establishing user fees that are fair both to the individuals receiving personal benefits and to taxpayers.

32.65 The fact that others benefit from the existence of a waterway has been used to argue that the actual costs incurred in providing for navigation should be shared. For example, a number of Parks Canada reports indicate that navigation represents

a benefit to land-based visitors, who have the opportunity to view the boats on the canal system. Accordingly, navigation is partially a public good and the cost should be shared by all taxpayers.

32.66 There are no recent visitor surveys that support the crucial assumption that land-based visitors receive a personal benefit from watching boats pass through the locks. The last survey of land-based visitors was completed in 1987. While that survey found that 57 percent of visitors to lock stations watched boats lock, it did not address whether land-based visitors were willing to pay for the benefit of watching boats. The survey also did not include the large number of visitors to the canals who do not visit lock stations. Parks Canada introduced a "report card" style survey for the 1996 season. This survey asks land-based visitors if they watched the boats lock through. However, it does not ask visitors if this activity is important to them, or whether this is a benefit that they should pay for. In fact, when land-based visitor fees were introduced at lock stations, attendance dropped dramatically.

\$ thousands

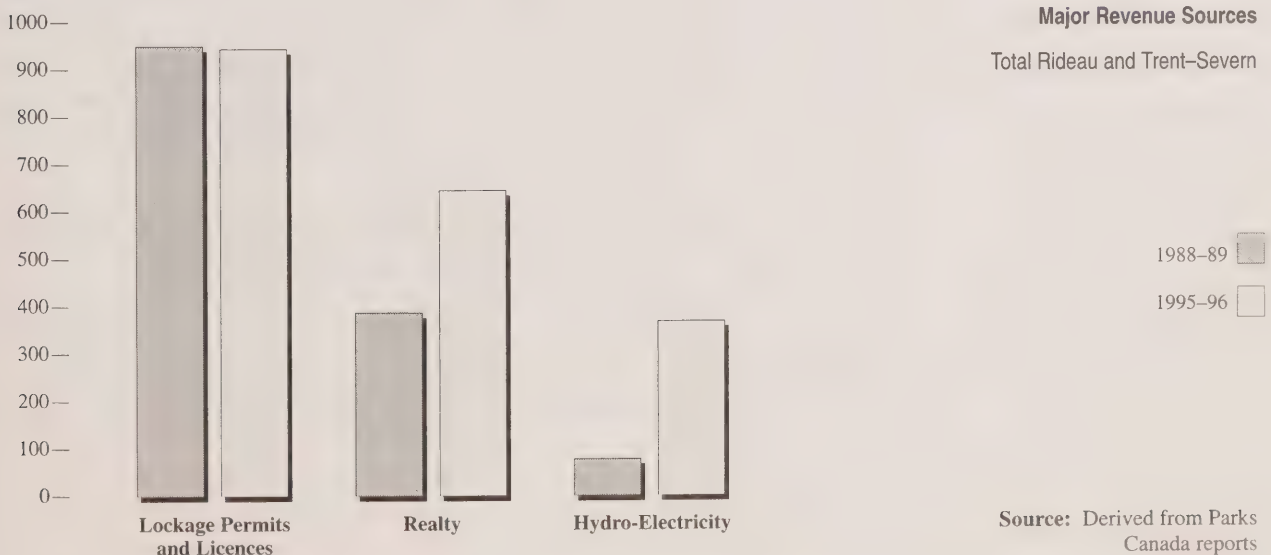


Exhibit 32.10

Major Revenue Sources

Total Rideau and Trent-Severn

Source: Derived from Parks Canada reports

It is difficult to argue that land-based visitors are receiving a personal benefit when they are unwilling to pay a minimal amount for it.

32.67 The *Corridors of Change* report states that 33 percent of total operating costs are allocated to land-based users, presumably for ground maintenance and a share of the maintenance of canal structures. The remaining costs associated with navigation are reduced by an additional 40 percent, due to an estimated public benefit. As a result, the reported cost of navigation is a fraction of the real cost incurred by Parks Canada. In addition, overhead costs and recapitalization costs are not included in the calculation. This method of cost allocation results in questionable information for use in determining user fees.

32.68 Parks Canada does not have adequate financial information to establish user fees accurately. For example, the additional maintenance and capital costs incurred to keep the locks operating and to ensure safe passage are not tracked separately from historical preservation costs. Parks Canada has indicated that the canal staff have significant responsibilities with respect to water control. However, there is a lack of both cost and performance information for this function. Consequently, the costs incurred to control and monitor water levels for navigational purposes compared with flood control and other purposes are not available, nor is there an appropriate basis for assigning resources to this function. This lack of complete cost information makes it difficult for Parks Canada to establish a fee structure that is sound and that reflects the costs of services provided.

32.69 Parks Canada should ensure that it has gathered the appropriate

information and performed the cost analysis necessary to establish user fees that are in accordance with Treasury Board policy. It should conduct a rigorous analysis of the public and private benefits derived from the canal systems, such that the establishment of user fees is properly supported.

Department's response: Parks Canada is improving its gathering and analysis of cost and performance information by class of beneficiary and will apply this information to the efficient management of the canal system.

Accountability not built into management plans

32.70 The development and management of each historical canal and its associated lands is based on a management plan, prepared by each canal, which establishes the direction of the canal for the next 10 years. The management plan for the Rideau Canal was completed in December 1995. The Trent–Severn management plan is in the final departmental and consultation phase.

32.71 Our examination of both the Rideau and Trent–Severn management plans and the Central and Eastern District Business Plan found that they do not adequately present realistic options for the future. The plans do not include an analysis of canal use to help identify potential operating efficiencies; nor are any concrete actions proposed for achieving cost recovery. The management plans lack specific operational objectives and timeframes for which canal management could later be held accountable. For example, while the plans focus extensively on partnership, there is no indication of which responsibilities, if any, will be divested to the partners, and what financial contribution toward operating costs Parks Canada expects from them. This information is also

Parks Canada does not have adequate financial information to establish user fees accurately.

lacking in the Business Plan. Without this information, it is difficult to understand how the objectives of each plan can be achieved.

32.72 Parks Canada should ensure that each canal management plan has clear objectives, associated activities and timeframes, and a clear accountability for meeting the established objectives.

Department's response: Management plans, business plans and management agreements together provide an integrated, comprehensive framework of planning and accountability for meeting established objectives.

Non-compliance with intent of Business Plan

32.73 The Parks Canada Business Plan, which was finalized in February 1995, covers the period 1995–96 to 1999–2000. It encourages Parks Canada managers to adopt more businesslike practices in the management of public funds. It also includes accountability for the wise and efficient use of resources. Investments are to be based on strict guidelines, criteria and objectives. We are concerned that a subsequent major investment decision, relating to the reconstruction of the Sault Ste. Marie Canal, was not in accordance with the intent and objectives of the Business Plan (Case 1 and Exhibit 32.11).

32.74 Parks Canada should ensure that major projects are subject to a rigorous business case analysis prior to decision making.

Department's response: Agreed. A business case analysis for the Sault Ste. Marie Canal began in 1988 and culminated with an agreement in principle in October 1994. The Parks Canada Business Plan was approved in 1995.

Preserving the best of the past — developing an approach for the management of historical resources

32.75 The Rideau Canal and Trent–Severn Waterway have an estimated asset replacement cost of \$913 million, which includes such assets as dams, locks, channels, walls, wharves, banks and buildings. Approximately 90 percent of these assets are marine structures. To the extent that all of these structures will eventually require recapitalization, they also represent a significant potential liability for Parks Canada. How these assets are recapitalized will therefore have a significant economic impact.

32.76 In 1985, a detailed assessment of structures on the Rideau Canal was undertaken to determine the best surviving examples. In order to select those most suitable to receive the fullest heritage protection, the structures were categorized as to high, medium and low historical significance (Exhibit 32.12).

32.77 Criteria used in the assessment were the uniqueness and structural integrity of the asset, and overall integrity of the site. With respect to structures with low historic significance, the report states, “Structures in this class have undergone significant alterations or else have been reconstructed in concrete with a stone masonry facade resulting in significant loss of original fabric.”

32.78 In 1995–96, assets on both canals were categorized into three levels — Level 1, Level 2 and Other — in accordance with the Cultural Resource Management Policy. A number of structures were classified as having higher historical value in 1995 than in 1985. In fact, a number of structures previously found to have low historical significance became Level 1 assets, with highest historical significance. Exhibit 32.13 illustrates the changes for locks only on

The Parks Canada Business Plan encourages more businesslike practices in the management of public funds.

A number of structures previously found to have low historical significance became Level 1 assets, with highest historical significance.

Sufficient funds are not available for recapitalization, yet there is no rational basis on which to allocate funds among competing projects.

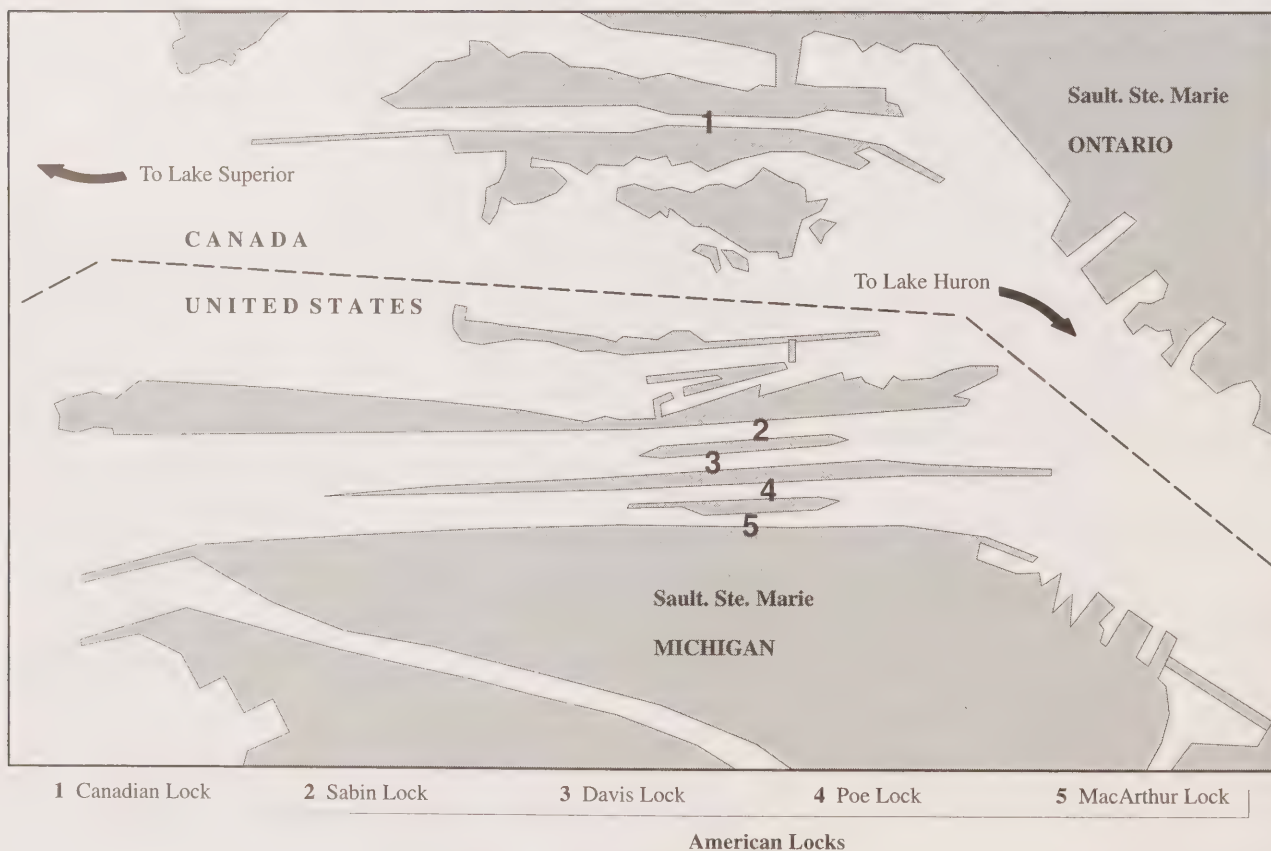
the Rideau system, although similar trends can be found for other canal structures, such as dams and bridges. We were informed by Parks Canada that the rationale for the change is based on intangible historic values rather than engineering assessments. We are concerned that such an assessment does not take into consideration reconstruction and restoration costs in a time of constraint.

32.79 The Rideau Canal has 91 assets identified as Level 1; 47 identified as Level 2; and 70 identified as Other. For the Trent–Severn, there are 30 Level 1 assets, 139 Level 2 assets and 184 assets rated as Other.

32.80 The original intent of classifying the structures along the canals was to identify the best surviving examples to preserve for future generations, based on their uniqueness and structural integrity. Had this classification been used, it would have enabled Parks Canada to target its scarce resources to preserving fewer assets. However, there is currently an extensive list of Level 1 assets that have not been prioritized, all of which are considered equally significant, and which will require full heritage protection. We were informed by management that sufficient funds are not available for recapitalization, yet there is no rational basis on which to allocate funds among competing projects.

Exhibit 32.11

Diagram of the Sault Ste. Marie Locks



32.81 We are also concerned about the treatment of resources rated as Other, which have little or no remaining historical fabric. The cost of replicating these assets is significant, as illustrated by the Ottawa locks case (Case 2). It is not evident that all of these structures need to appear historical or be operated in an historical fashion. Both maintenance and recapitalization costs could be reduced through careful selection and preservation of a few representative examples.

32.82 Parks Canada should review the categorization of assets for the purposes of protection and preservation so that available funds can be directed to those of greatest historical value.

32.83 Where structures are restored so that little historical material remains, Parks Canada should consider the most cost-effective options.

Department's response: Agreed. Resources should be properly directed to the cultural resources of historic significance.

Need for better management information

32.84 The lack of useful, reliable information for making fundamental decisions about canal operations was raised in the 1987 Task Force report and the 1993 *Operational Reviews* of canals. We noted a similar lack of information during our audit. In addition, information on the operations of canals is not provided to Parliament.

32.85 A reliable visitor data system does not exist for either water or land-based visitors. Parks Canada estimates that there were approximately three million land-based visitors to the Rideau Canal and Trent–Severn Waterway in 1993–94. This estimate does not include those who visit the canal at

locations other than lock stations. The total number visiting the canal corridor is estimated to be close to 10 million. Both our examination and the results of Parks Canada's reviews indicate that statistics on land-based visitors are considered unreliable. In addition, an independent 1992 economic analysis indicated that land-based visitors had been significantly undercounted.

32.86 Furthermore, there is no attempt to count the actual number of boats passing through the system. For example, the Rideau Canal and Trent–Severn Waterway report 84,000 and 187,000 boats respectively through their locks for 1994–95. However, the same boat may be counted many times as it passes from one lock to another. We estimate that no more than 8,000 boats used the Rideau Canal locks and no more than 20,000 used the Trent–Severn locks during that year, based on the number of lockage permits sold. These data have implications when one is considering reducing operations, determining the impact of fee increases, or performing economic analysis.

32.87 For example, the amount of revenue that Parks Canada could earn from 28,000 boat owners would be considerably less than could be obtained from 271,000 boat owners. Without

We estimate that in 1994–95 no more than 8,000 boats used the Rideau Canal locks and no more than 20,000 used the Trent–Severn locks.

Exhibit 32.12

1985 Classification of Historical Assets

Level of Historical Significance	Recommended Recapitalization
High	The fullest heritage treatment is provided, with total preservation of original fabric and historically authentic methods of repair (i.e. more labour-intensive).
Medium	The original fabric is preserved where possible and, for replacement, historically appropriate methods of construction are used where possible.
Low	Authentic methods of repair are not as important, as long as historic appearance is maintained.

knowing the population to which fee increases apply, Parks Canada cannot determine their potential impact. It is also difficult to understand how Parks Canada can analyze options in levels of service without knowing the population that uses those services. A reduction in level of service could affect very few boaters who are crossing the same lock many times. We also note that the foundation for the 1992 economic impact analysis of the canals was based on the number of boats using them. As this number was not available from Parks Canada, an estimate of 198,141 boats was made, based on other available information.

32.88 Information on whether boaters are Canadian or foreign is not gathered for trend analysis. Although management plans indicate the importance of marketing the canals to international boaters, it will be difficult to determine the success of such programs without this type of information. A 1986 survey of boaters indicated that 88 percent of boaters reside in Ontario, 9 percent come from the United States, one percent from other countries, and 2 percent from provinces other than Ontario. Since that time, only one survey has inquired about the origin of boaters. That survey was conducted at the Ottawa locks only, and therefore cannot be considered representative of all boaters using the Rideau Canal. The origin of boaters is also

crucial in estimating the canals' economic contribution to local and provincial economies. There are assumptions that boaters on a canal spend a certain amount per day. However, boat traffic patterns suggest that many of the boaters, particularly on the Trent–Severn, are local cottagers. Cottagers are likely to be spending in the local community whether or not the locks are operating. In this case, the additional contribution to the local economy may be less than estimated.

32.89 We also noted that the reported economic impact of \$44 million includes Parks Canada's operating and capital expenditures. The additional economic benefit beyond direct expenditures by Parks Canada is approximately \$20 million. Economic benefits are not reported for land-based visitors compared with boaters, although this information is available in a detailed economic impact analysis, which was based on 1990 boater data and 1987 land-based visitor data. That analysis indicated that land-based visitors to lock stations on the Rideau and Trent–Severn accounted respectively for 75 percent and 66.7 percent of total land-based and boater expenditures. As boat lockages have declined by 18 percent since 1990, these percentages may no longer be accurate. Consequently, the current information is out-of-date and not reliable for decision making. In addition, the detailed economic analysis indicates

Exhibit 32.13

Classification of Locks on the Rideau Canal

Level of Historical Significance	1985	1995–96	Change in Level
High or Level 1	10	39	+29
Medium or Level 2	16	0	–16
Low or Other	22	8	–14
Unknown	0	1	+1
Total	48*	48*	–

* The 48 locks exclude two locks on the Tay Canal branch of the Rideau, and include Smith Falls lock 29a.

CASE 1 – SAULT STE. MARIE CANAL

Business Plan investment criteria not met, resulting in significant potential liability and funds to be disbursed without a definite need**Background**

Continuing declines in commercial use resulted in the Sault Ste. Marie lock being transferred from the St. Lawrence Seaway Authority to Parks Canada in 1979, for use primarily by recreational traffic. Commercial traffic has historically used the four much larger American locks, located nearby (Exhibit 32.11). At the time of the transfer, a government decision directed that the St. Marys and Whitefish Islands, on both sides of the Canal, be developed into heritage parks. The “heritage park” concept encompassed a major visitor reception centre, outdoor interpretive exhibits, an extensive trail system, large day use areas, boat stop-over facilities and boater camping. Development of the parks was to commence as soon as Parks Canada assumed responsibility for the Sault Ste. Marie Canal. These heritage parks have not been developed as envisioned.

In July 1987, subsequent to a structural failure of the south wall, the canal was closed to navigation. Since that time, all traffic has used the American locks.

Studies and discussions of options have been ongoing since the failure of the lock wall. These have resulted in a tripartite agreement between the federal government, the Ontario government, and the City of Sault Ste. Marie, dated 6 September 1995. The federal and provincial governments have agreed to share the costs of constructing a recreational lock within the now closed lock at the Sault Ste. Marie Canal. At the

time of the agreement, the total cost was estimated to be \$10.4 million. Ontario would contribute 50 percent of the capital costs up to \$6 million. Prior to the agreement, Parks Canada's position was that it would not pay any of the operating and maintenance expenses of the lock, once constructed. Letters and documents state: “The fact that there is an operating canal on the US side for boaters does not justify creating further federal operating expenses at the Canadian site,” “Our bottom line is simply to operate as a national historic site” and “The Parks Canada mandate for the protection, presentation and commemoration of the historically significant resources at the Canal is fully met whether the lock is operational or not.” Despite this, the City of Sault Ste. Marie would not accept full responsibility for operating costs. The final agreement indicated that while operating and maintenance responsibility for the lock itself would rest with the City, Parks Canada would contribute 75 percent of the annual operating and maintenance costs. Lockage, mooring and site entrance fees, if any, would be turned over to Parks Canada. Under the terms of this agreement, Parks Canada will continue to operate the historic site in the vicinity of the lock.

Options considered for the site prior to the agreement, costs for the first five years and totals over 30 years are shown in the table below.

The analysis for the recreational lock notes that repairs to various canal structures and equipment would still be necessary to operate the lock safely and efficiently. The estimated total cost would be \$28 million over a 30-year period.

The Parks Canada Business Plan

While discussions were ongoing for the reopening of the Sault Ste. Marie Canal, Parks Canada was preparing a Business Plan. A final version of the Business Plan was released on 13 February 1995. The Business Plan sets out five logical “investment streams” along with criteria for considering financial allocations. Resourcing decisions focus on three main objectives: operating the current system of parks and sites; improving the condition of the heritage assets; and expanding the system of parks and sites. Within these objectives are three sub-objectives: reducing expenditures on current operations; addressing the most threatened heritage assets first; and achieving the 1996 targets for park system completion.

Investment stream four, “New investments in existing parks and sites”, applies in the case of the Sault Ste. Marie Canal. This stream was used to approve the work. The criteria under this stream include:

- consistency with approved management plans;
- acquisition of new assets only if no other options exist to protect heritage resources;
- investments that will increase revenue or decrease operational expenditures;
- investments with revenue potential that demonstrate they will achieve the appropriate level of cost recovery in reasonable time; and
- a business case analysis that demonstrates a positive net present value or is justified based on a specific qualitative assessment.

Option	Cost (5 Years)	Cost (30 Years)
Permanent closure of lock	\$ 2.1 million	\$ 5.2 million
Historic park	\$ 4.4 million	\$ 9.0 million
Recreational lock	\$ 10.4 million	\$ 28.0 million
Restoration back to previous dimensions	\$ 25.0 million	\$ 31.0 million

CASE 1 – SAULT STE. MARIE CANAL (Cont'd)

Issues

Businesslike approach not followed

We are concerned that Parks Canada did not carry out a rigorous, business case analysis prior to deciding to proceed with the reconstruction of the Canal. The analyses of revenue potential and economic impacts are not well supported and they were completed subsequent to the decision being made. Although final agreement for this project was signed in September 1995, discussion was ongoing during the previous 14 months. The major project, with significant dollar implications, was approved in principle in October 1994, without due consideration of the draft business plan and its investment stream criteria. A business case approach would have questioned the validity and rationale for the project.

The criteria included in the business plan would have ensured a proper businesslike assessment of the decision to reconstruct the recreational lock at Sault Ste. Marie. Specifically, most of the above investment stream criteria were not met. There is an interim plan but no final management plan for the canal. The new construction would not lead to improved protection of heritage assets; rather most of the floor and gates would be removed, thereby destroying these particular heritage resources.

Weak economic analysis

The economic analysis is notably weak, relying on general interpretations of 1985 tourism data, which indicated that 3.8 percent of tourists to the area were interested in historic sites, and 30 percent were interested in sightseeing. This gives "the impression" that the tourists would visit an operating canal. It further relies on informal surveys of visitors to the local tourist office to reach "the impression that 40 percent of visitors interested in pleasure/recreation may be interested in viewing the new canal." We find this to be weak as

economic analysis for such a major project, involving significant investment.

Revenue calculations optimistic

Revenue calculations include \$30,000 per annum anticipated from the historic site, whether the canal is operating or not. This amount now becomes revenue foregone, as under the agreement it will go toward Parks Canada's 75 percent contribution to operating and maintenance costs. Parks Canada's proposal to charge \$10 per boat for lockage has yet to be established in the context of free lockage on the American side. The \$10 fee may potentially violate an existing agreement between Canada and the United States. The American locks have been able to handle the number of recreational boaters, which has declined significantly in recent years. One lock is dedicated to recreational traffic.

The economic argument that the public and communities benefit from lockages is difficult to support. Benefits to the communities derive from visitor expenditures. In the case of Sault Ste. Marie, only 3.8 percent of tourists are interested in historic sites. The economic benefits would therefore be relatively low. We have seen no analysis to indicate that an operating lock would make a substantial difference over a static site. We also note that only one Canadian tour boat company has expressed interest in using the Sault Ste. Marie lock. Parks Canada estimates that 2000 recreational boaters will use the lock annually.

Cost estimates may be understated

We are especially concerned that cost estimates may be understated, both for operations and for capital. Parks Canada has indicated that the change from a full-sized lock to a recreational lock will reduce operating costs from the previous \$1.2 million annually to \$140,000.

However, other departmental estimates place operating costs between \$160,000 and \$270,000. Although various studies have been carried out over nine years, capital cost estimates have risen by \$2.2 million from \$10.1 million in early 1995 to a total of \$12.3 million. This raises the federal government's share by 20 percent, already above the maximum approved, and work has not yet begun. As the amount exceeds \$10 million, Parks Canada is now seeking approval from the Treasury Board for the project. We also note that the prior options analysis included funds for restoring the historical buildings on the site, as well as improving facilities for visitors. These additional funds are not included in the tripartite agreement. If anticipated operating costs, as projected by Parks Canada, and the amortization on a \$12 million capital investment are considered, we estimate an annual cost of almost \$1 million. This amounts to taxpayers paying the equivalent of \$430 each time a recreational boat uses the lock.

Conclusion

The project has not been subjected to a business case analysis that demonstrates positive net present value. The analyses available indicate that none of the capital would be recovered, that limited potential for increased tourism exists and that the historic resources can be adequately protected and interpreted without the canal being operational. The federal share of \$6.3 million appears to be a regional or local development expenditure, which is not within Parks Canada's mandate. In addition, the development of an historic park appears to be more consistent with the direction provided by the government at the time of the Canal transfer.

In our view, if a rigorous business case analysis had been performed, continued operation of the historic site and the permanent closure of the lock would clearly be the most cost-effective option.

that there are significant direct expenditures by land-based visitors who do not visit lock stations, such as visitors to resorts and those attending special events on the canals. This information is important in analyzing the economic impact of reducing canal services.

32.90 The Maintenance Management System was designed to aid in the planning and recording of maintenance

work (hours and cost). We noted that the system is used to varying degrees, and that it is not used for year-end reporting because the data are considered unreliable. Our 1989 audit of the Canadian Parks Service reported that underuse of the maintenance management system is impeding efficiency improvement, and that few system-wide reviews of maintenance functions have been conducted. Since that time, no

CASE 2 – OTTAWA LOCKS

\$18.3 million spent to restore seldom used locks containing little historic fabric

Background

The Ottawa locks, located in the heart of Ottawa between the East Block of the Parliament Buildings and the Chateau Laurier Hotel, are the final set of locks on the northern end of the Rideau Canal where it joins the Ottawa River. The elevation change from the Rideau Canal to the Ottawa River is 24 metres, and eight locks are linked together to make the transition. In the early 1980s, it was determined that the locks were in serious need of repair due to time and water damage. A multi-year project was undertaken to restore them to good operational condition while retaining the heritage appearance.

The project involved three parts. Locks one to three were completed in 1986 for \$9.8 million, locks four and five were completed in 1988 for \$3.8 million, and locks six to eight were completed in 1993 for \$4.7 million. Parks Canada has been unable to provide us with the actual total cost of this major capital project, including all in-house design and supervision. We compiled the cost from the Estimates. In total, approximately \$18.3 million was spent on the eight locks. The difference in the cost per lock reflects the development of new engineering techniques, such that some of the original wall could be salvaged

for locks six to eight, although new facing stones were required. For the other locks, the walls were completely demolished. As a result, locks one to five have been classified as "Other", the lowest heritage rating. Locks six to eight have recently been classified as Level 1 assets, the highest level of historical significance, due to the remaining wall. In order to make the locks appear authentic, stone was hauled from the Bruce Peninsula, cut at St. Catharines, then bush hammered and etched onsite to give the appearance of the original work done by a stone mason.

In the last three years, these locks have been used by an average of 2,000 boats annually. This compares with over 7,000 boats at the busier locks on the Rideau, and over 10,000 at some Trent–Severn locks. Relatively little traffic uses the Ottawa locks because of the time involved, more than two hours, in the eight lockages. Tourists visit the museum and lock site, but it is not clear that the movement of boats through the locks attracts greater numbers.

Issues

Although the entire Rideau Canal was designated as an historic site by the Historic Sites and Monuments Board, it does not imply that all sites along it must be preserved in an historical fashion. Our audit has noted that Parks Canada continues to treat all sites as equal for major construction.

We are concerned that Parks Canada undertakes major construction projects, to authentically replicate assets, without having first prioritized those assets. This prioritization would determine appropriate levels of restoration and ensure that those sites having the most valuable heritage resources receive adequate and timely attention.

Our second concern centres on the extent of use of these particular locks. The overall locks were closed for a number of periods during reconstruction with little apparent disruption. We are concerned that the return on the expenditure of \$18.3 million will be minimal, and in the course of completing this project, other more deserving projects may not have had funds available. The Ottawa locks can effectively represent an historic place without the occasional boat passing through. In effect, the reconstruction to operational standards was not well analyzed.

Conclusion

We recognize the objectives of Parks Canada in the restoration of historical sites. However, prioritization as well as appropriate analysis and impact of sites restoration are important business practices that should have been applied as part of the decision making to reconstruct the Ottawa locks.

Parliament has no quantitative or qualitative information on the benefit Canadians are deriving from the operation of these canals.

significant review of the canal maintenance function has been undertaken. Given the number of resources dedicated to the maintenance function (88 full-time staff and 60 term positions as at May 1996) and the potential for future contracting-out of this activity, it is important that reliable information on maintenance requirements and costs be captured.

32.91 We noted that Part III of the Estimates does not include any information on canal operations, such as justification for resource use, performance indicators, strategic initiatives, or quantitative goals with respect to heritage resources. Without such performance information, Parks Canada management and the Department cannot be held accountable for the economic and efficient use of public funds. Most important, Parliament has no quantitative or qualitative information on the benefit Canadians are deriving from the operation of these canals.

32.92 Under the revised Expenditure Management System, Part III of the Estimates will be replaced with departmental plans and departmental performance reports. This offers Parks Canada the opportunity to improve information to Parliament on the activities of the historic canals.

32.93 Parks Canada should develop more complete and useful economic information to support planning for the future of specific canal sites.

32.94 Parks Canada should ensure that the maintenance function reflects actual needs; identify contracting-out options; and ensure that reliable and complete data are collected for decision making.

32.95 Parks Canada management should ensure that Part III of the Estimates, or reports required under the revised Expenditure Management System, include strategic initiatives, objectives, results and performance indicators.

Department's response: Agreed. More relevant and reliable information will be used for management decision making, responding to government reporting and accountability initiatives such as improved reporting to Parliament and the revised Expenditure Management System. Results and performance measurement are integral to the Department of Canadian Heritage planning and management cycle.

Overall departmental response: There is a clear difference of viewpoint between the audit report and the Department of Canadian Heritage with respect to the Historic Canals. The Department takes the view that it has a legal and policy mandate to protect the natural and historic features of the canals; to provide for their enjoyment and use by maintaining through navigation for boaters and accessible public space along the canals; and to provide water management for the conservation of natural values and the protection of private and public properties. We are reducing costs, moving to market rates for personal use, and developing and supporting marketing efforts to increase overall tourism and economic benefits from the canals. The Department acknowledges the need to define costs and benefits associated with the specific mandates.

The audit report does not recognize the Parks Canada mandate, but focusses only on boating. It thus concludes that Parks Canada should close less-used locks, creating major disruption of benefits to tourists and communities along the canal system.

We have not yet found a way, nor have the auditors been able to suggest a way, to

derive revenues from all visitors, local residents and others who receive a private benefit from the canals. The auditors have recognized that “visitors along the canal use the sites as park land, for picnicking, walking, observation and fishing” and that “water control, wetland and wildlife conservation, realty rights and privileges” are among the many services provided by Parks Canada in addition to preserving canal structures and providing for navigation.

All Canadians benefit from our mandate to protect and present the cultural and natural heritage resources that the Historic Canals represent. As a public good, those costs are funded by general

government revenue. Therefore a gap between costs and revenues will remain.

We are pleased that the audit recognizes the efforts made by Parks Canada to introduce innovative labour practices within the constraints of legislation and in the context of efforts made to introduce change in the operation of the Historic Canals. The introduction of the Parks Canada Business Planning approach, the implementation of the recommendations of the Corridors of Change report with its focus on marketing, as well as efforts to reduce costs and increase revenues clearly demonstrate our commitment to change. We continue to seek innovative ways to be even more efficient.



About the Audit

Objective

Our audit objective was to assess whether Parks Canada is managing the canals in an efficient and cost-effective manner, given its mandate and priorities. We conducted our audit by interviewing personnel, visiting a number of canal locations and reviewing documentation and reports.

Scope

Our audit focussed on the management of the Rideau Canal and Trent–Severn Waterway, as these two canals represent 77 percent of total canal operating costs, 67 percent of the capital cost, and 90 percent of the boats moving through locks. However, many of our audit findings pertain to the other canals as well. We have also examined the proposed reconstruction and reopening of the Sault Ste. Marie lock.

The Rideau Canal links the cities of Ottawa and Kingston via a 202 kilometre route. It consists of 49 locks at 24 lock stations. The Trent–Severn Waterway extends 386 kilometres from Trenton on Lake Ontario to Port Severn on Georgian Bay. It comprises 44 locks, including two hydraulic lift locks and a marine railway. There are also some 125 dams that provide an adequate water level throughout the navigation season.

Criteria

Our audit criteria were the following:

- Historic canals should be managed with due regard for economy and efficiency.
- The Department of Canadian Heritage should develop and apply appropriate economic criteria to meet transportation needs on the canals.
- The Department of Canadian Heritage should have and provide relevant, timely and accurate performance information to Parliament.

Approach

We interviewed officials of Parks Canada at headquarters and at the regional offices in Smith Falls, Peterborough, Cornwall, Halifax and Sault Ste. Marie; we also visited a number of lock locations. In addition, we examined relevant documents including departmental and other studies, parliamentary debates and Part IIIs of Estimates. We also held a stakeholders meeting to better understand the needs of stakeholders with respect to national parks and historic canals.

We consulted with the Department's Corporate Review Branch. As the Branch had not carried out a review of the management of the historic canals, it could not supply additional data.

Audit Team

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For information, please contact Harry A. Ruthnum, the responsible auditor.

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Report of the
**Auditor General
of Canada**
to the House of Commons

Chapter 33
Indian and Northern Affairs Canada –
Funding Arrangements for First Nations

November 1996



Chapter 33

**Indian and Northern
Affairs Canada**

Funding Arrangements for
First Nations

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants.

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Indian and Northern Affairs Canada

Funding Arrangements for First Nations

Assistant Auditor General: Don Young
Responsible Auditor: Grant Wilson

Main Points

33.1 In recent years, annual budgetary expenditures for Indian and Northern Affairs Canada have averaged over \$4 billion. Approximately \$3 billion of these funds are administered and spent by First Nations, tribal councils and other recipients for education, social assistance, infrastructure development and other needs mainly on reserves. This level of funding is expected to continue to at least 1998–99.

33.2 Currently, the Department uses up to six types of funding arrangements or components thereof, through which annual funding is transferred to recipients. Most funding arrangements are in the form of contributions with terms and conditions attached.

33.3 During 1993–94, the Department identified a need to rethink existing funding arrangements to clearly articulate the relationship with First Nations. A new Financial Transfer Arrangement (FTA) is being designed to replace most existing arrangements by 1998–99. The Department's expectations of this new arrangement are to strengthen accountability, better meet community needs, achieve better value for money and encourage other positive impacts.

33.4 The Department has adopted three principles of accountability relating to transparency, disclosure and redress to assist in strengthening accountability. It is proceeding to develop an accountability framework in which First Nations governments are expected to be primarily accountable to their community members. The Department continues to be responsible to Parliament for the way it handles its resources.

33.5 The audit found that:

- ongoing deficiencies in implementation are being encountered in current funding arrangements;
- the Department has not completed its determination of how the new FTA will help address identified problems and achieve the intended improvements;
- up to 65 percent of devolved expenditures in fiscal year 1995–96 were subject to more restrictive funding arrangements. This suggests that there is a considerable way to go to implement the Financial Transfer Arrangement and achieve its benefits within the changing relationships between the parties;
- the Department invited little input from its intended funding recipients when deciding to proceed with the FTA, and First Nations and tribal councils have expressed concerns; and
- the Department has acknowledged the need to address agreed-upon accountability and results expectations and is proceeding accordingly.

33.6 The Department, together with First Nations, tribal councils and other recipients, needs to intensify efforts to resolve the issues encompassing funding arrangements. In so doing, the parties must be able and willing to identify and effectively address the shared risks associated with their evolving relationships, while meeting their respective needs for accountability.

Introduction

Background

33.7 Although their living conditions are improving, many First Nations people in Canada do not enjoy the same standard of living as other Canadians. Exhibit 33.1 sets out some figures for 1991 on socio-economic conditions.

33.8 In past years, we have audited and reported on various programs funded by Indian and Northern Affairs Canada, which directly affect the living standards of First Nations. The purpose of this audit was to review the Department's funding arrangements to help identify opportunities for improvement. The arrangements through which funding is provided are important factors influencing the cost effectiveness of programs delivered on reserves and, ultimately, the standard of living of the recipients. Further details on our audit objective, scope and criteria are found at the end of the chapter in the section **About the Audit**.

33.9 Since 1995, the stated policy of the federal government has been to recognize the inherent right of Aboriginal self-government. Indian and Northern Affairs is negotiating and working with First Nations to help them implement this

inherent right. This audit of funding arrangements considered this evolving relationship between the federal government and First Nations. Because funding arrangements and administrative, political and social evolution are intertwined, funding arrangements must recognize that evolution and support its success.

First Nations Funding

33.10 The Department has the primary federal mandate for funding basic services such as education, housing, roads, water and sewage systems, and social and family services to registered Indians living on reserves. It also has specific trust responsibilities for Indian money, estates, reserve lands and band government; negotiates the settlement and implementation of specific claims and comprehensive land claims; and promotes economic development and fulfills obligations under various Indian treaties.

33.11 Indian and Northern Affairs is not the only federal department that funds Aboriginal programs. Other federal entities include the departments of Health, Human Resources Development and Canada Mortgage and Housing Corporation. The observations and recommendations in this chapter relate to funding arrangements administered by Indian and Northern Affairs.

	Registered Indian Population	Canadian Population
Average individual income	\$10,141	\$19,188
Social assistance dependency rate on reserve	41.5%	8.2%
Suicide rate per 100,000	35.0	12.1
Dwellings having more than one person per room	11.4%	1.3%
Population with schooling less than grade 9 level	27.9%	13.9%

Exhibit 33.1

Comparison of Socio-Economic
Conditions, 1991

Source: Indian and Northern
Affairs Canada

Each year, approximately \$3 billion appropriated by Parliament is spent by First Nations under various funding arrangements with the Department.

33.12 Since 1994–95, the annual budgetary expenditures for the Department have averaged over \$4 billion. Approximately \$3 billion of this is administered by First Nations, tribal councils and other recipients under various funding arrangements with the Department. Exhibit 33.2 outlines funding earmarked for Aboriginal programs on and off reserves for 1995–96.

33.13 Funding for First Nations consists of a combination of obligatory and discretionary responsibilities of the Department arising out of treaties, and legislation such as the *Indian Act* and *Appropriation Acts*. Although there is no apparent consensus between the government and First Nations as to what is obligatory and what is discretionary, ultimately, the Department is responsible to Parliament for the way in which it uses appropriated funds.

Current Direction of Indian and Northern Affairs Canada

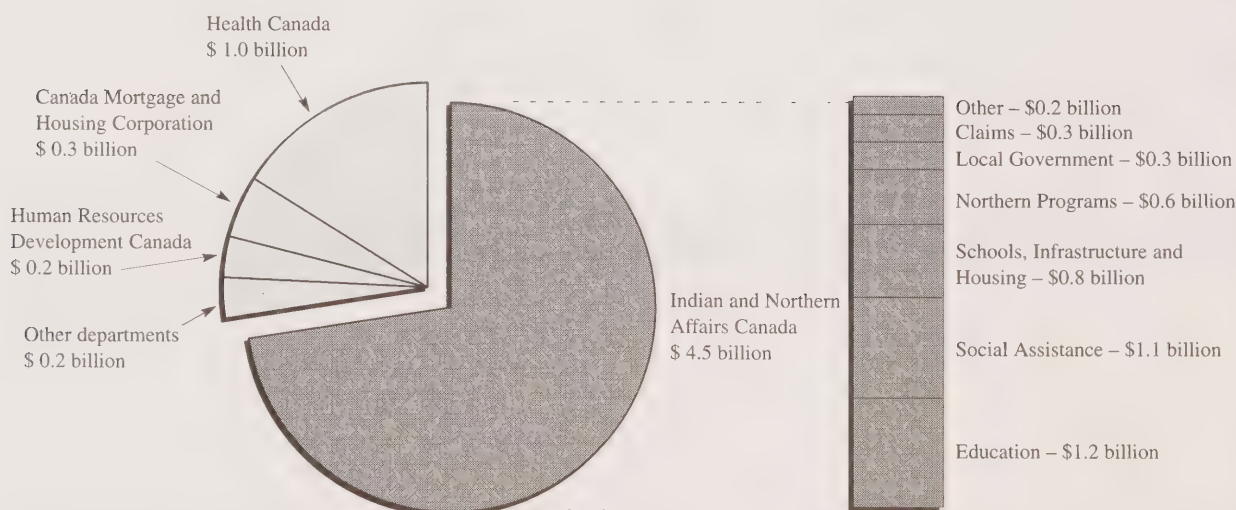
33.14 The Department is committed to continuing the devolution of programs to First Nations and to implementing the inherent right of self-government. The Department's goals for 1996–97 include:

- negotiating Aboriginal self-government;
- transferring jurisdiction and accountability to First Nations;
- settling land claims; and
- improving on-reserve living conditions.

33.15 At one time, the Department directly managed the delivery of numerous programs in Indian communities; however, the delivery has now devolved significantly to First Nations. Currently, the Department's primary role is to design and manage

Exhibit 33.2

Federal Programs Directed to Aboriginals, 1995–96



Source: Indian and Northern Affairs Canada (Unaudited)

funding arrangements that appropriately support program delivery in a manner consistent with devolution and to help First Nations position themselves to assume greater self-government responsibility. As more self-government agreements are negotiated, the Department's role is expected to diminish.

Funding Recipients

33.16 Recipients served south of the 60th parallel include approximately 600 First Nations and over 80 tribal councils. According to Indian and Northern Affairs, about 36 percent of the communities are located in urban areas, 45 percent are rural and 19 percent are in remote or special access areas.

33.17 The total estimated registered Indian population in 1996 is approximately 620,000. In 1994, there were 574,000 registered Indians of which 337,000 (about 59 percent) were living on reserves. Government projections to the year 2005 indicate an expected on-reserve population of over 400,000. Most First Nations are small; approximately 75 percent consist of less than 1,000 registered members and 50 percent have fewer than 500.

The Challenge

33.18 First Nations are not homogeneous. In addition to size and location, they differ from one another in many ways, including their preparedness to resolve outstanding issues with the Department, to assume responsibility for program delivery and, ultimately, to implement the inherent right to self-government. Consequently, solutions to a given issue may not be appropriate to all First Nations. Indeed, the issues themselves may not apply universally.

33.19 Funding arrangements need to exhibit principles of cost effectiveness. They need to enable a variety of complex programs such as social assistance, education and infrastructure development to be implemented under widely differing circumstances. They must also require appropriate accountability and encourage its realization. The Department is responsible for the nature, design and application of funding arrangements. It has a responsibility to ensure and demonstrate, to parliamentarians as well as to the First Nations recipients of funding, that it uses the most appropriate funding arrangements.

33.20 An appropriate funding arrangement is one that is well designed and properly implemented to achieve its objectives. Both design and implementation must effectively identify and mitigate the applicable risks of failure. Such risks include:

- inconsistency between funding arrangements used and the needs of funding recipients;
- inability to complete a funded project;
- cost overruns;
- delivery of substandard goods and services;
- improper use of funds and other non-compliance with the funding arrangements;
- financial failure of the recipient; and
- general program failure.

33.21 Since most program delivery is performed by the funding recipients, the Department needs to know how such risks are managed. However, this does not necessarily mean that the Department should establish more controls.

33.22 As devolution proceeds, the relationship between the Department and

First Nations are not homogeneous and differ from one another in many ways.

Source: Indian and Northern Affairs Canada

Characteristics of Funding Arrangements and Authorities

	Contribution Agreement (CA)	Comprehensive Funding Arrangement (CFA)			Alternative Funding Arrangement (AFA)	Financial Transfer Arrangement (FTA)	Self-Government Financial Transfer Arrangement (SG-FTA)	Grant
		(CA)	Flexible Transfer Payments (FTP)	Grant				
Eligibility	Meet specific program eligibility criteria	As noted under contribution agreement	Meet specific program eligibility criteria	As noted under grant	All First Nations and their organizations may apply AFA entry criteria must be met	All First Nations and their organizations are eligible Risk assessment performed	All First Nations and their organizations are eligible Self-government legislation or agreements required	Class of recipients
Multi-year	One year	As noted under contribution agreement	One year	As noted under grant	Five years	Five years	Five years – negotiable	Possible
Negotiation	Each program activity negotiated individually	As noted under contribution agreement	Each program activity negotiated individually	As noted under grant	One agreement for all services with overall budget Can also have agreements with Solicitor General (police) and Health Canada	Agreements are developed at the same time for all programs Other federal departments may participate	Comprehensive multi-program multi-department funding agreement	Provided to support the achievement of specific objectives
Community Program Design	Departmental programs as stipulated	As noted under contribution agreement	Departmental program standard to be maintained	As noted under grant	Programs may be redesigned subject to minimum program requirements	Programs may be redesigned subject to minimum program requirements	Programs may be redesigned subject to legislative requirements	Possible
Deficits Funded by Crown	If supported by eligible claims	As noted under contribution agreement	No	As noted under grant	No	No	No	Not applicable
Surplus Retained by Recipient	No	As noted under contribution agreement	Yes	As noted under grant	Yes	Yes	Yes	Not applicable
Audit and Reporting Requirements	Audit and monthly/quarterly operational and financial reports	As noted under contribution agreement	Operational reports, audited statement of overall financial position of the band	As noted under grant	Annual audit and information return containing management attest and supporting information regarding minimum program requirements	Annual audit and information return containing management attest and supporting information regarding minimum program requirements	Annual audited financial statement of the band	Audit and other reports not required
Percent of Total Value of 1995-96 Funding Arrangements	32.2%	Included in 32.2%	32.5%	Included in 5.2%	26.3%	3.4%	0.4%	5.2%

First Nations is changing toward a partnership where both parties have responsibilities. Funding arrangements need to reflect this relationship and clearly set out the responsibilities and the expectations of each party. They also need to take into account the skills and resources of the parties. Finally, they need to contain provisions for ensuring that each of the parties is kept informed of the extent to which expectations have been met and for ensuring appropriate responses to results achieved.

Observations and Recommendations

Current Funding Arrangements

33.23 The design and use of the current array of funding arrangements have evolved over at least the past 10 years. The overall purpose was to use arrangements that were consistent with ongoing program devolution to First Nations, to accommodate departmental downsizing and to facilitate a match between the various arrangements and the needs of different recipients.

33.24 Currently, there are six types of arrangements or components thereof in use, with some First Nations using more than one type. A seventh arrangement, now being tested, is planned to replace most existing arrangements. Each arrangement has different characteristics, as set out in Exhibit 33.3. With the exception of grants, each arrangement is a form of contribution, containing applicable terms and conditions, with various reporting requirements designed, according to the Department, to encourage First Nation capacity, compliance and accountability under the circumstances.

Results of the Review of Current Funding Arrangements

33.25 Indian and Northern Affairs uses several methods to encourage the implementation of funding arrangements by First Nations to agreed standards. The main ones are:

- use of eligibility entry assessments for certain arrangements;
- the inclusion of specific terms and conditions in funding arrangements;
- casual and formal monitoring of financial results and program delivery; and
- the application of high-risk threshold indicators and related remedial action plans.

33.26 All of the above-noted methods have merit and can contribute to effective program delivery while encouraging due care; however, success in their application is not always evident.

Specific observations on selected funding arrangements

33.27 We reviewed 48 cases of funding arrangements, having a total estimated value of \$1 billion over the life of the agreements. In addition to those outlined in Exhibit 33.4, our observations are as follows:

- Provisions in funding arrangements generally include requirements to report operational statistics (outputs, such as goods and services provided) but these do not always include information on outcomes (the effect of providing these goods and services) or quality of service provided.
- There is inadequate evidence of ongoing verification by the Department of certain operational information provided by funding recipients. This information is used to justify budgets and actual

Our review of funding cases identified problems in risk management, accountability and implementation.

Six types of funding mechanisms are in use today.

expenditures. The unreliability of certain data is known to the Department.

- The Department's information on accountability within the communities funded is incomplete.
- Over 20 percent of First Nations' financial statements contain qualified audit opinions or denials of opinion. This suggests there may be a higher risk of implementation failure.
- The submissions of audited financial statements to the Department by several First Nations and other recipients are frequently late and in general these statements reflect poor financial results.
- Reviews of financial information are often not performed promptly once the information is received.
- Information disclosed by First Nations does not always include all operations of the funding recipient. For example, the gaming operations of certain First Nations are not reported. Therefore, the Department's risk assessments are not based on all the relevant information. Consequences could include unintentional

overfunding and selection of an inappropriate funding arrangement.

- Entry assessments required to determine suitability for certain funding arrangements are frequently missing from departmental files.
- Amendments to some funding arrangements are numerous. This could reflect implementation difficulties.
- There was late detection of a calculation error in base entitlement, leading to cumulative overfunding of about \$1 million to one recipient (identified by the Department after three years).
- In one region, the Department instructed certain bands to retain surplus funds, comprising over \$3 million resulting from a downward change in the application of provincial social assistance rates. Some of these funds may have been recoverable from those First Nations under the terms of the funding agreements. We did not attempt to determine the maximum possible amount recoverable for any region, but other regions may also be affected.

33.28 The nature of the problems identified suggests that similar difficulties

Exhibit 33.4

Selected Findings of Case Reviews

Alternative Funding Arrangement (AFA)/ Financial Transfer Arrangement (FTA) Only	Required	Found	
Entry assessments	25	13	
AFA/FTA annual return of information	25	16	
AFA/FTA/ Comprehensive Funding Arrangement CFA)/ Contribution Agreement (CA)	Required	Found	Late
Bands and other recipients audited financial statements	48	44 ³	34 ¹
Indian and Northern Affairs analysis of the audited financial statements	48	40	23 ²

Notes:

1. The average lateness of the audited financial statements was 51 days.
2. The average lateness of Indian and Northern Affairs analysis of the audited financial statements was 61 days.
3. There were 34 unqualified audit opinions and 10 qualified audit opinions (including denials).

may be encountered in funding arrangement cases not audited. Two cases, from our sample of 48, described in the shaded Special Inserts on pages 33–13 and 33–16, provide more detailed illustrations.

Entry assessments

33.29 Entry assessments are used by the Department to evaluate the financial, managerial and technical capacities of the funding recipients to mitigate risks. By so doing, the Department and First Nations can better determine which type of funding arrangement is appropriate for a particular recipient.

33.30 The assessments, for example, are required for the Alternative Funding Arrangement (AFA). Applicants who do not meet assessment criteria are deemed to be higher risk and may be offered another funding arrangement, such as a Contribution Agreement, which is less flexible. Appropriate application of assessments can help mitigate risks and allow for the appropriate arrangement under the circumstances.

33.31 However, as observed in the findings of our case reviews, AFA assessments were frequently missing from the Department's files. Moreover, some First Nations who passed the AFA entry assessment were placed under a Remedial Management Plan, a restrictive agreement between the recipient and the Department to encourage financial improvements, because of deteriorating financial positions during the AFA period.

33.32 Indian and Northern Affairs does not usually update these assessments during the term of the AFA or when it is renewed up to five years later. Instead, the Department relies on the audited annual financial statements provided by First Nations to determine overall financial condition. However, these are received after the fact and do not provide the needed assurance on program management.

33.33 The audit also disclosed different requirements for entry assessments. For example, under the Comprehensive Funding Arrangement (CFA), there is no requirement for an entry assessment. However, under the Flexible Transfer

TRIBAL COUNCIL DIFFICULTIES UNDER AN ALTERNATIVE FUNDING ARRANGEMENT

A First Nations Society, acting on behalf of nine First Nations, entered into a five-year Alternative Funding Arrangement (AFA) with Indian and Northern Affairs Canada effective 1 April 1990. The initial value of the AFA was \$76 million, which grew to \$104 million during its term.

The Society's 1993–94 audited financial statements show that it had paid \$559,000 to an European firm to secure financing of \$4 million (US). There was little indication of the purpose of the financing and no indication of whether it was obtained. Although the amount is shown as an investment, its realization is not determinable. The \$559,000 was paid

when the source of virtually all of the Society's funding was the federal government.

As well, in 1993–94, the Department provided the Society with an additional \$1 million for claimed social assistance needs that were not foreseen when the funding arrangement was completed in 1990. This was followed in December 1994 and January 1995 by payments totalling another \$1 million for more unforeseen events.

In 1995, the Society reported a surplus of almost \$1 million in social assistance funds. The Department commenced recovery action for this amount in

December 1995 by offsetting other moneys owed to the Society. By then, according to the Society, four of the nine member First Nations in the Society had terminated their membership. The Society expressed its concerns to the Department that it (the Society) had no means of recovering the portion of the surplus relating to these First Nations.

In our view, the Department should have obtained appropriate information on the purpose and use of the \$559,000. In addition, the Department needs to review more vigorously requests for additional funding for unforeseen events and periodic financial statements to identify emerging surpluses.

Payment (FTP) component of the CFA, the recipient is responsible for funding deficits, as in the case of the Alternative Funding Arrangement, which does require an entry assessment. The lack of a required entry assessment for FTPs increases the Department's vulnerability to risks.

33.34 As well, the lack of entry assessments for all First Nations and tribal councils means that potential opportunities may be missed to identify those presently funded under a Contribution Arrangement but who might qualify for an Alternative Funding Arrangement (AFA). Some First Nations have resisted adopting the AFA entirely or partially for some programs funded by it. The reasons relate to the sharing of program risk and cost. Under Contribution Arrangements, the Department retains all the risk because funding is provided on a cost-reimbursable basis for eligible expenditures.

33.35 The Department should carry out entry assessments of funding recipients to determine the suitability of every funding arrangement to mitigate risks and to achieve desired results.

Funding for tribal councils

33.36 Tribal councils are organizations that provide a wide range of advice and assistance to member First Nations at their request. The use of these services can be important to the well-being of the membership.

33.37 The Department funds tribal councils directly. Under these arrangements, tribal councils can enter into contracts with First Nations members for specified services. Councils may also transfer funds they have received from the Department to First Nations members for the provision of contracted services.

33.38 The Department has not estimated the total value of its arrangements with tribal councils; nor did it know the total value of service contracts between the councils and First Nations. Consequently, it is difficult for the Department to ensure that value for money has been obtained for the services provided or that tribal councils are the best vehicle for such matters. For example, the Department may not always be aware of any differences between the planned use of services funded by tribal councils and the actual services delivered.

33.39 Although we recognize that benefits can be provided by tribal councils, there are concerns that the Department needs to address. For example, where there is a decrease in actual use of a service, the tribal council and/or the First Nation member may be overfunded. Further, services included in the service contract between a council and a First Nation may not be delivered as intended.

33.40 We also noted that where a tribal council transfers funds received from the Department to a First Nation, the council has in effect further devolved program delivery, which gives rise to potential accountability concerns. The Department intends to complete an evaluation of tribal council services.

Current accountability issues

33.41 In 1991, we reported that the Department's funding arrangements lacked adequate accountability. Significant consequences included inadequate assurance on whether funds to First Nations were being spent for the purposes intended, were conducive to achieving expected results and were being spent in the most efficient manner.

33.42 In response to our 1991 observations on accountability, the

Department stated that it was increasing the authority provided to First Nations to manage departmentally funded programs and that it would emphasize the importance of accountability by Indian Councils to their own constituents. The Department further acknowledged that it was prepared to accept and manage the business risk inherent in the transfer of authority.

33.43 In 1996, the Department published its adoption of three principles of accountability, defined as follows:

- Transparency: the government's (First Nation as well as Department) method of operation is known by citizens.
- Disclosure: citizens are informed of the government's (First Nation as well as Department) plans and actions.
- Redress: citizens can appeal decisions affecting them individually or collectively.

33.44 The Department's plans for 1996–97 include encouraging and assisting First Nations to codify their governance and administrative practices, thereby helping to strengthen their local accountability. In June 1996, the Department wrote to First Nations Chiefs and Councils requesting that funding recipients complete an assessment of their accountability and management systems based upon basic principles and mechanisms common to governments in Canada, and that they develop an action plan to address any gaps. The assessment the extent to which such systems are in place would henceforth be a requirement of all funding arrangements. At the same time, the Department commenced formal meetings with selected First Nations to identify appropriate accountability.

Matters to resolve

33.45 It is clear that accountability is an area requiring greater consideration. This was made evident from the views expressed by First Nations, both in response to the funding arrangements survey we carried out with First Nations and in our Office's study reported in September 1996 on First Nations accountability, which sets out the concept of shared responsibilities in a partnership. Achieving appropriate accountability requires that, among other things, the parties involved have the political and management wills to agree on what accountability should be and how it should be determined. A major hurdle is the need to develop a definition and criteria for accountability that are tailored to the respective needs of all parties.

33.46 The case described in the shaded Special Insert on page 33–16 relating to First Nations difficulties is also an example of accountability concerns.

33.47 In some ways, a serious gap has developed between the implementation of the political agendas and ongoing management needs in both the Department and First Nations. For example, the Department has been implementing program devolution for many years without obtaining corresponding assurances of appropriate accountability. According to the Department, in 1994–95, almost 82 percent of expenditures under the Indian and Inuit Affairs Program were administered through band councils, tribal councils and other First Nations organizations.

33.48 Devolution and self-government initiatives require accountability that is consistent with their needs. Broader questions that still need to be resolved

The Department is encouraging and assisting First Nations in strengthening local accountability.

**Questions relating to
accountability need to
be addressed.**

jointly between the Department and First Nations include the following:

- What are the agreed-upon roles, responsibilities and performance expectations of the respective parties? Who is accountable and to whom (consider the roles of First Nations, community members, the Department and Parliament)?
- What results are expected and by whom? Who needs accountability information — First Nations communities? First Nations Leadership? First Nations managers? Department managers? the Minister's Office? Parliament?
- Should accountability between First Nations leadership and members affect the accountability between the Department and First Nations?
- Is the information provided sufficiently results-based? What decisions will be made as a consequence of

producing accountability information — by whom?

- How should the implementation of accountability mechanisms be tailored to meet the different needs of First Nations?
- To what extent, if any, should the above matters be reflected in funding arrangements terms and conditions?
- What monitoring, if any, should be done? By whom?

33.49 Resolution of the above-noted questions is an urgent matter, given the economic plight of many First Nations communities, the trend toward self-government and the quest for value for money. As in mainstream communities and government in general, available resources are dwindling. Consequently, there is increasing need to use existing funds in the best possible way. Appropriate accountability can help achieve this.

FIRST NATIONS DIFFICULTIES UNDER AN ALTERNATIVE FUNDING ARRANGEMENT

In March 1995, Indian and Northern Affairs Canada entered into a five-year Alternative Funding Arrangement (AFA) with a First Nation for approximately \$90 million, replacing a 1990 AFA.

The most recent management and accountability assessment performed for this recipient was in 1989, in connection with the 1990 AFA. At that time, the assessment disclosed several significant concerns relating to governance and accountability. In addition, the First Nation was already operating under a remedial management plan designed to improve its financial situation.

Despite these concerns, the Department proceeded with the 1995 AFA, without updating the management assessment. In September 1995, the Department expressed several concerns to the First Nation respecting its financial situation and program deficits.

The Department requested that the First Nation submit a revised remedial management plan, acceptable to the Department, by October 1995. However, this request has not yet been satisfied.

The following problems were noted from the 1995 financial results:

- The First Nation's auditor found serious deficiencies in the accounting records and in the system of internal control. He was unable to satisfy himself that all the revenues and expenditures of the First Nation had been recorded and that the recorded transactions were proper; as a result, a denial of opinion was issued on the financial statements.
- The auditor also disclosed that the First Nation's accumulated deficit (\$3.9 million) and debt load (\$9.3 million) may impair its capacity to effectively deliver the programs for

which it is responsible unless certain remedial actions are taken.

- The First Nation's auditor noted that although the First Nation's gaming operations had generated significant funds, they were not reported to the Department and therefore not taken into account when the funding arrangements were implemented. The auditor indicated that such funds could make a significant contribution to retiring the First Nation's debt.

This case demonstrates the importance of close co-operation between the Department and its funding recipients, and the need for effective and prompt action according to the circumstances. It is also consistent with the broader issues raised on whether or not information provided by First Nations should reflect all their activities, and not just those funded by government.

33.50 Departmental funding includes both discretionary and obligatory elements. Discretionary funding is all funding that is not provided to satisfy existing statutory, treaty and other ascertained obligations. Should accountability requirements be the same for both types of funding? This is an issue that the Department and its funding recipients will need to resolve.

33.51 The Department needs to respond to the different accountability needs, capabilities and priorities of different First Nations and tribal councils. Although the Department has adopted principles of disclosure, transparency and redress, it has not completed its determination of how these would be applied in practice under different circumstances. The Department is contemplating a wide range of accountability requirements.

33.52 The Department together with First Nations should determine how appropriate accountability between the parties can be achieved. This should include defining, as a minimum, the responsibilities and expectations of each party, methods for determining and communicating the extent to which expectations have been met, and provisions for ensuring appropriate action. As well, the Department should take into account the skills and resources of the parties and the accountability within the community between First Nations leadership and members.

What information exists? What needs to be done?

33.53 The Department places considerable reliance on the audited financial statements of funding recipients as a major input to accountability. Financial statements provide a picture of

the financial health of a First Nation. Among other things, they can demonstrate trends and alert the user of this information to obvious or potential problem areas.

33.54 However, financial statements are not designed to reflect program outputs, successes and failures. They may not even reflect the audited costs of individual programs; nor, in the case of non-consolidated statements, will they show the complete financial position of the First Nation.

33.55 The Department recognizes that program information is also needed. Examples include data on the quantity and quality of services provided and, where feasible, the results obtained for the money spent.

33.56 The Department routinely gathers much of its information from funding recipients based on three reporting packages containing almost 550 pages. The packages gather a combination of information — statistical, financial and some program/operational-type information — covering funded activities such as capital facilities and maintenance, economic development, education, social assistance services and others. However, the Department has been unable to indicate the significance of this information in terms of demonstrating accountability. Nor can it demonstrate with this information that the funding arrangements used are appropriate.

33.57 Together, these information-gathering activities are costly and time-consuming to the Department and to First Nations. Moreover, the Department's reporting expectations of First Nations can be particularly burdensome, especially when one considers that over half of the First Nations have fewer than 500 members.

The Department, with First Nations, needs to determine information requirements.

33.58 The financial statements of First Nations and tribal councils are provided to the Department annually to also help determine the most suitable type of funding arrangement and to assess risks that may need special attention. We observed instances where the Department does not have information on all the financial activities of the funding recipient.

33.59 The use of only partial information can result in inappropriate risk assessments and an inappropriate selection of the funding arrangement to be implemented. Further, the Department is unable to fully determine the causes of deficits and surpluses and the most appropriate action to be taken. As well, the Department's ability to effectively monitor compliance with funding arrangements — a responsibility that it still retains — is impeded.

33.60 The Department should determine with First Nations what information is necessary for the selection of appropriate funding arrangements, to support accountability and to assist in the allocation of financial resources.

How Some First Nations View Funding Arrangements

33.61 We surveyed over 200 First Nations and tribal councils for their views on the existing and planned funding arrangements. Forty responses were received representing views of recipients from virtually all regions, from different size communities and with different funding arrangements.

33.62 No audit was performed of the survey responses and no audit conclusion should be inferred. The responses are opinions and no assumptions should be made about Aboriginal communities, in general, with respect to the survey issues summarized below. The responses do serve, however, to give a flavour of how funding arrangements are perceived by many.

33.63 A number of First Nations' suggestions on how to improve funding agreements, along with additional comments, are set out in Exhibits 33.5 and 33.6. General issues raised by those responding to the questionnaire include the following:

- Most responding First Nations that have funding arrangements containing

Exhibit 33.5

Suggestions from First Nations on How to Improve Funding Agreements

- Agreements should be similar to federal-provincial agreements.
- There should be better reporting to First Nations members.
- More consultation with First Nations should take place.
- More funding is required.
- Funding should be tied to need.
- There should be minimum funding for certain programs.
- No direct funding should be provided to intermediaries such as tribal councils.
- Constant changes to reporting requirements should not happen.
- All reporting to the Department should be streamlined once a year.
- More staff are required for processing of paper and accountability requirements of the Department; small bands are expected to produce the same documentation but with less staffing.
- Funds should be given to First Nations at the start of a project.
- First Nations governments should be provided with the necessary powers that will allow them to raise their own revenues by sharing all tax revenues raised within their territory.

tighter terms and conditions, as found in Contribution Agreements (CA) and Comprehensive Funding Arrangements (CFA), would like less restrictive funding arrangements.

- A majority of those with Alternative Funding Arrangements (AFA) or Financial Transfer Arrangements (FTA) found them suitable to their needs. However, some with FTA indicate that they are ready for even less restrictive funding arrangements like federal-provincial funding arrangements with no conditions attached.

- Most respondents with CA and CFA indicated that present funding arrangements did not meet their needs for

flexibility in allocating funds to the community programs and for reporting how well programs are achieving the results expected. Most with AFA and FTA indicated that these arrangements did meet their needs in these areas.

- First Nations responding expressed mixed feelings about the opportunity to provide adequate input into the type of funding arrangements needed.

- Although almost all respondents indicated that they provide financial reports to community members at least annually, many indicated that they did not provide regular performance reports on the quality and quantity of services delivered to the community. However,

Funding Arrangements

- First Nations have had some difficulty with the Department changing the intent of the terms and conditions (more reporting requirements) of Alternative Funding Arrangements (AFA).
- The Department's AFA reporting requirements are not consistent with First Nations reporting needs.
- Block funding will not meet the needs of a population increasing at three times the national average.
- There was very little input from First Nations regarding the FTA and the changes to the reporting requirements.

Financial Difficulties

- The lack of funding, poor financial management and political pressure within the First Nation are some of the causes of financial deficits.
- First Nations are accountable for programs that are only partially funded, which creates a deficit. They cannot administer a program with insufficient funds and hope to achieve results.
- In some instances, financial deficits are due simply to overspending for no valid reason.

Self-Government

- There are problems of continuity: elections under the *Indian Act* stipulate two-year terms of office. Council is constantly changing.
- Self-government means getting all the necessary funding and preparing the same reporting vehicles but they would be submitted only to our own band members.
- Devolution is not self-government, it is an administrative transfer of responsibilities.
- First Nations and the Department have different concepts of self-government. The Department's self-government booklet is flawed, as the Department is a big step away from what First Nations think of as self-government.

Co-ordination

- Co-ordination among federal departments needs to be changed. Some agreements are like the Department's agreements of 10–15 years ago.
- First Nations should have one arrangement for all federal funding; the only thing blocking this is bureaucratic inertia.

Exhibit 33.6

Other Comments from First Nations to Funding Arrangements Questionnaire

A new funding arrangement is being tested with plans to replace all current arrangements by 1998–99.

several First Nations indicated that they wished to improve on this last point.

- A majority of respondents did not feel that present funding arrangements are consistent with their interpretation of self-government.

- A majority who responded, even those with pilot FTA, felt that co-ordination among federal departments for the purposes of funding needed to be improved.

33.64 Overall, the responses demonstrated a variety of views, both positive and negative. This is not surprising given the varied composition of First Nations and tribal councils. Among other things, the implications are that funding arrangements must be appropriately flexible to meet specific needs.

33.65 The Department should consider the comments of First Nations and seek their additional input in addressing the needs of recipients for different types of funding arrangements.

New Funding Arrangement

The Department makes changes

33.66 In acknowledging that improvements were necessary, the Department identified in 1993–94 a need to rethink existing funding arrangements in order to reduce First Nations dependency, to improve efficiency and to clearly articulate the relationship with First Nations. The new, single, funding arrangement known as the Financial Transfer Arrangement (FTA) was the product of this rethinking.

33.67 The FTA is now in draft form and some testing is being carried out on its application to selected First Nations. The Department expects to simplify the

several types of arrangements currently in use while staying within its overall budget. It eventually plans to replace all of the arrangements with the FTA, with complete implementation by 1998–99.

Objectives and benefits

33.68 The Department considers that the FTA is being introduced on the basis of a more clearly articulated framework for First Nations accountability. It believes that First Nations governments are primarily accountable to their community members for their governance and efficient and effective delivery of programs and services. They are also accountable to the Crown for the use of funding provided by the Department.

33.69 The Department expects that the FTA will:

- strengthen accountability;
- enable First Nations to better meet community needs;
- establish a stable funding base; and
- enable better value for money to be obtained.

33.70 The Department is promoting the FTA as an improved arrangement. We note that its intended benefits are similar to those under the Alternative Funding Arrangement (AFA). That arrangement has been in use for over 10 years. According to the Department's own comparisons in June 1995, two major differences relate to accountability, which is still to be determined, and to the greater use of population factors in determining funding-level adjustments.

33.71 The Treasury Board authorities used by the Department for its current funding arrangements are at least seven to ten years old. A significant change in funding approach or in terms and conditions would normally require a new

Treasury Board approval. For example, when the Department introduced Flexible Transfer Payments in 1989, it sought and obtained specific Treasury Board authority.

33.72 We were advised by the Department that no new authority was deemed necessary for the Financial Transfer Arrangement (FTA). The 10-year-old Alternative Funding Arrangement authority would apply. Of course, a new authority alone would not necessarily confirm that there has been a major improvement or even a major change.

Experience with a similar arrangement

33.73 The ongoing implementation of the Alternative Funding Arrangement (AFA) since 1986 has not, according to the Department, achieved its take-up goals. For example, the planned, cumulative AFA utilization was 101 recipients by 1987, 254 by 1988, and 405 by 1989.

33.74 The Department reported that by the spring of 1989 the actual utilization of AFAs was 38 recipients, or about 9 percent of the target. By the spring of 1996, there were 173 active AFAs, or about 25 percent of the maximum possible utilization, if applied to all First Nations and tribal councils.

33.75 Some First Nations, according to the Department's assessment, may not be ready to assume the extra authority and responsibilities provided to them under the AFA. Others may be qualified to use the AFA, but they prefer other types of available arrangements, such as the Contribution Agreement, for certain programs because eligible expenditures are cost-reimbursable. Accordingly, the recipient assumes no risk for potential deficits. The Department has no national

data on the extent to which each of these reasons apply.

33.76 The Department reported that as of 1995–96 about \$3 billion had been placed under First Nations administration. Up to 65 percent of the value of devolved expenditures was subject to more restrictive (non-AFA) funding arrangements. This suggests that there is a considerable way to go to implement the FTA and achieve its benefits within the changing relationships between the parties.

Testing and input from recipients

33.77 As of March 1996, the development of the Financial Transfer Arrangement was in the testing phase, with 17 pilot projects, some of which commenced in 1993. With the exception of these pilot projects, the Department has not generally invited First Nations to provide their input into the design, implementation and reporting requirements of the new arrangement. The Department indicated that the results of the pilots are still unknown. Nevertheless, it is proceeding with general implementation of FTAs as the current arrangements with First Nations expire. In our view, the Department needs to continue to assess the results of the pilot projects and obtain additional input from First Nations and other recipients not included in the pilots before committing itself to widespread FTA implementation.

Impacts on recipients

33.78 Which recipients will benefit from the proposed FTA and how? Will any be disadvantaged by it? Will funding levels change for certain First Nations? The Department was unable to produce an analysis that adequately addressed these questions. For example, the FTA has the potential to affect small, medium and large First Nations differently. The lack of

appropriate impact analyses or feasibility studies may lead to unnecessary confusion and anxiety in First Nations.

33.79 In addition, the Department did not satisfactorily show how responsive the FTA will be to ongoing departmental downsizing, and how the FTA reflects the move toward Aboriginal self-government.

Application of Financial Transfer Arrangement

33.80 A single model of the FTA is being tested. This approach could mean that varying degrees of risk and recipient needs will not be appropriately addressed. However, the Department has indicated that it will tailor terms and conditions to mitigate risk and help satisfy the need for overall accountability.

33.81 The Department should continue to assess the results of its FTA pilot projects before proceeding with the implementation of FTA funding on a broader basis.

33.82 The Department should ensure that the Financial Transfer Arrangement meets the government's and First Nations' needs by reaching agreement with First Nations on the responsibilities and expectations of each party relative to the funding arrangement. The arrangement should take into account the skills and resources of the parties and enable the parties to know whether expectations have been met and the resulting consequences.

Surpluses and Deficits

33.83 Flexible Transfer Payments, Alternative Funding Arrangements and Financial Transfer Arrangements permit recipients to retain or use surpluses that may arise during the implementation of their funding arrangements. Surpluses can

result for several reasons, including efficient delivery of services. The arrangements also require recipients to be responsible for any deficits that may result.

33.84 The Department needs to manage risk while encouraging the transition to the FTA and ultimately to full implementation of the inherent right to self-government. Accordingly, we expected to find summary information on surpluses and deficits resulting from the implementation of funding arrangements. Such information could assist the Department in modifying its policies and funding allocations where appropriate.

33.85 We found that the Department has no national database on the generation and use of surplus funds. The Department needs to know the cumulative value of surpluses, their frequency of occurrence and the significant factors that contributed to them. It should also be aware of how recipients use surplus funds. For example, were they used for eligible program needs, for financing other First Nations activities, or for other purposes? Minimum program requirements and standards must be met before surplus funds are used for other purposes. These requirements relate to social assistance, education, membership registration and land management, and may include other items as stipulated in the funding arrangements.

33.86 The Department accumulates information on deficits from the financial statements submitted by First Nations and tribal council recipients, and monitors their size and occurrence against predetermined criteria on a First Nation/tribal council-entity basis. One significant criterion applied is whether the recipient's overall deficit exceeds eight percent of its annual revenue. In such instances, a more detailed review is performed to consider whether a Remedial

Implementation of the Financial Transfer Arrangement is intended to address identified problems.

Management Plan is needed and, if so, one is developed by the Department and the recipient to address the deficit. Generally, this plan attempts to achieve a reduction in debt, improve internal controls or remedy other concerns.

33.87 Deficits are tracked routinely in the regions and reports are provided to headquarters for monitoring. According to the Department, there were 217 First Nations and tribal councils (almost one third) either in need of a Remedial Management Plan or operating under one, as of January 1996. Included were 54 cases where the deficits exceeded annual revenues by 24 percent up to 102 percent.

33.88 Based on information produced by the Department, the total value of reported deficits for First Nations and tribal councils was over \$190 million for 1994–95. Like surpluses, deficits may occur for several reasons. The Department identified some of the causes that have led to deficits: deficient management capabilities, losses from activities carried on outside of Department-funded programs, weak accountability regimes and inadequate management systems. Some First Nations have stated that, among other things, deficits are a result of inadequate base-level funding, populations that have increased dramatically over the past few years and changing social and political imperatives.

33.89 Different types of funding arrangements involve different levels of risk. Accordingly, we expected to find data on Remedial Management Plans classified by type of arrangement; however, this information was not complete. Consequently, it is more difficult for the Department to identify the higher-risk cases for priority action.

33.90 We are concerned about the pervasiveness of deficits and their present

and future impact on First Nations, tribal councils and government. Although the best-designed funding arrangement is unlikely to prevent deficits by itself, it can play an important role in managing them. Today's situation has emerged under funding arrangements that have been in place for about 10 years. Furthermore, the Department has not demonstrated how the new Financial Transfer Arrangement will improve the deficit experience.

33.91 The Department should modify its existing databases to ensure that it obtains and uses on a national basis appropriate information relating to surpluses and deficits. This information should include, for example, the type of agreement subject to Remedial Management Plans, and summaries of surpluses and deficits and the main factors leading to them.

Co-ordination with Other Federal Funding Entities

33.92 Several departments provide significant funding to First Nations under their own funding arrangements. According to the Department and a majority of First Nations respondents to our questionnaire, First Nations would like the delivery of federal programs to be co-ordinated at the community level. They have expressed concern about the complexity and administrative burden in dealing with the many departments. The Department noted that at the 1992 General Assembly of First Nations a motion was carried recommending that one funding arrangement be developed to include multi-department funding.

33.93 The Department reports that some progress has been made in terms of joint participation in projects through common funding arrangements. The

potential consequences of using different funding arrangements can include:

- confusion in Aboriginal communities as to what is expected of them through different funding arrangements;
- inefficiencies in funding administration because of a lack of “one-stop shopping”; and
- a potential for duplication of services provided and related costs.

33.94 In our view, appropriate design and implementation of a single arrangement may offer improvements in serving First Nations’ needs and harmonizing such things as reporting requirements. This could be achieved without necessarily transferring funds through only one department.

33.95 The Department should consult with First Nations, and other federal entities that fund Aboriginal programs, with a view to determining the best way to co-ordinate funding arrangements for federal programs at the First Nation community level.

Conclusion

33.96 Funding arrangements formalize the relationship between parties in addressing specific financial needs to deliver intended programs. The history of funding arrangements offered and used under program devolution records a consistent presence of related, unresolved issues. However, funding arrangements may not require more controls. They need to be supportive of the goals and objectives of each party and facilitate devolution and political and social evolution. They also need to promote the achievement of intended results and help provide assurances to the parties that results are achieved as expected and redress is provided as required. Ultimately

there is a need for all parties to be accountable to each other and to their respective constituents.

33.97 In addition, adequate flexibility of arrangements to ensure their cost effectiveness, and proper implementation of risk management together with appropriate information sharing by all parties will enhance the arrangements. We believe that if the issues identified in this audit are effectively addressed through consultation, the Department and its funding recipients will be in a better position to meet their needs in the evolving relationship.

Department’s response: In this report, the Auditor General has identified some of the many challenges facing the Department as its relationship with First Nations evolves. The relationship is complex, and demands that the Department be responsive to the different circumstances of First Nations, while ensuring that the fundamental requirements of accountability and cost effectiveness are observed. Increasingly, the responsibility to meet these requirements is shared by both parties.

The Department and First Nations are building on their experience with previous funding arrangements to test a new Financial Transfer Arrangement (FTA) through pilot projects. The Department is discussing the arrangement with First Nations representatives across the country, as it designs the FTA for broad implementation. Having carried out joint reviews of the pilot FTAs, it is the Department’s view that FTAs represent an important step in the right direction, which is consistent with the First Nations’ views reported in this chapter, as well as the Auditor General’s September 1996 chapter on First Nations perspectives on accountability.

FTAs will strengthen accountability and clearly articulate the responsibilities of both parties. The Department has

instituted numerous actions to strengthen accountability, including:

- a requirement that all First Nations complete an assessment of their management and accountability system;*

- the development of action plans where required to address the recommendations of the assessments;*

- review and feedback on audited financial statements; and*

- remedial management plans, where required.*

As the fundamental shift toward increased local accountability takes place, continued dialogue among First Nations and government is vital to securing mutually beneficial and cost-effective accountability regimes.



About the Audit

Background

For many years, one theme that has continued through our audits of programs funded by Indian and Northern Affairs Canada is the need for appropriate accountability for the billions of dollars allocated to the Department and eventually spent by First Nations and other recipients.

This audit of funding arrangements considered the rapidly evolving relationship between the Government of Canada and First Nations. A major feature of the relationship is the government's formal policy, announced in 1995, to recognize the inherent right to self-government claimed by Canada's Aboriginal peoples. Funding arrangements are set within this environment and are central to addressing the social and political aspirations of First Nations.

Objective

Appropriate funding arrangements and their effective implementation are essential if current and future self-government initiatives are to be successful. At issue are how well program results are achieved and ultimately the standard of living on Indian reserves. We also believe that the spending of parliamentary-approved funds needs to be accompanied by appropriate assurances that funds are used as authorized.

Accordingly, the main objective of the audit was to determine whether existing and planned funding arrangements and their implementation are appropriate in terms of the evolving relationship between the federal government and First Nations.

Scope and Approach

The audit addressed funding frameworks and arrangements between Indian and Northern Affairs Canada and First Nations, tribal councils and other recipients, which account for approximately \$3 billion annually. It took into account issues involving existing funding arrangements whose design can be traced to 1989, 1986 and prior, and also considered the Department's current development of a new funding arrangement.

To complement the audit work in headquarters, our approach included field visits to about half of the Department's regional offices. We also surveyed over 200 First Nations and tribal councils.

In addition, we reviewed 48 individual cases representing a variety of funding arrangements with First Nations, tribal councils and other recipients having an estimated value over their terms of \$1 billion.

There was no attempt to audit the adequacy of funding levels or needs, as these matters have been addressed in recent audits by this Office.

Criteria

Among other things, funding arrangements need to:

- exhibit principles of cost effectiveness;
- identify and mitigate applicable risks of failure;
- enable implementation of a variety of complex programs such as social assistance, education and infrastructure development under widely differing circumstances;
- provide for appropriate accountability and encourage its realization; and
- facilitate devolution and progress in political and social evolution.

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November 1996

**Report of the
Auditor General
of Canada
to the House of Commons**

Chapter 34
National Defence – Support Productivity

Chapter 35
National Defence – Follow-up of the
Auditor General's 1994 Report



November 1996

This November 1996 Report comprises 19 chapters, including “Matters of Special Importance”, as well as a Foreword and the Main Points from the May, September and November 1996 Report chapters. In order to better meet clients’ needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.

Chapter 34

**National Defence –
Support Productivity**

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants.

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National Defence – Support Productivity

Assistant Auditor General: David Rattray
Responsible Auditor: Peter Kasurak

Main Points

34.1 Operational units of the Canadian Forces are sustained by a national support system of 29 bases that provide support services, which cost \$2 billion each year to operate.

34.2 The Department is undergoing significant change because of modifications to defence policy and resource reductions in the last three Budgets. It is cutting personnel and closing bases at the same time as it is implementing a management renewal program. These pressures, coupled with efforts to increase the proportion of resources assigned to combat forces, increase the complexity of managing change. Nevertheless, the Department is committed to implementing most major changes between 1994 and 1999.

34.3 At the corporate level the Department's renewal initiatives are under way, but few concrete results are visible yet. Senior officials told us it was still too early to expect their initiatives to have achieved results.

34.4 Senior management wants staff to think of themselves as active, cost-conscious resource managers rather than "resource custodians". Survey data indicate that while most in the Department are receptive to change, the Department will have to overcome significant obstacles to create an empowered, self-starting labour force. It has taken commendable steps to deal with changing values and beliefs, but more needs to be done to educate staff and to provide incentives.

34.5 Most base managers say they cannot get all the cost information they need when they need it. Performance information is lacking on most bases.

34.6 At the working level, we found that productivity improvements were inconsistent. In some cases productivity has declined:

- In spite of some major improvement initiatives, labour productivity in base supply declined 10 percent from 1992–93 to 1995–96 because the level of activity fell more rapidly than the level of supply personnel. Senior officials believe this is only a temporary problem and their efforts will result in overall improvements.
- Kilometres driven per driver by base transportation services varied widely, with drivers at the best-performing bases driving five times more kilometres than those at the lowest-performing bases.
- Vehicle maintenance productivity was lower than in industry. While military requirements may account for part of the difference, the Department has not calculated how much of a difference such requirements make.
- Air maintenance is improving, with millions saved on the DASH-8 aircraft and the CF-18 at Cold Lake. However, improvement appears to have stalled, and bureaucracy, lack of financial responsibility and lack of cost information are still problems.
- The training system's productivity was not competitive with the private sector in 1990 and has become 40 percent less productive since then.

34.7 In order to meet the Minister's goal of producing the defence capabilities described in the 1994 White Paper with 25 percent fewer resources, support productivity must begin to increase now.

Introduction

Why Support Productivity Matters

34.8 The operational ships, land force brigades and air squadrons of the Canadian Forces are sustained by a national support system that provides personnel support, equipment, food, fuel, maintenance and training. The overall support system consists of 29 Canadian Forces bases where operational units are stationed, and national and command headquarters that provide general management of the individual support functions. Support functions consume 46 percent of the National Defence budget each year.

34.9 “Productivity” is the rate at which resources are used to produce or deliver a given quantity and quality of products. The more productive an operation is, the fewer resources it will consume in delivering its products. The more productive support operations are, the more the resources that can be devoted to combat and combat support units. The size of the support effort needed to sustain the Canadian Forces makes productivity particularly important. In the face of fixed budgets and continuing budget cuts, any increase in expenditure on support reduces spending on the size of the combat force, its readiness or its modernization through the purchase of new equipment. In his *1996 Departmental Outlook* the Minister of National Defence said that budget cuts are “not expected to affect the roles or capabilities of the Canadian Forces described in the 1994 Defence White Paper.” In order to meet this expectation, the productivity of support elements must increase as fewer resources become available to support the same combat capability.

Turning the Department Around

Previous audits showed low productivity

34.10 Over the past six years, we have audited a significant number of National Defence support functions. In general, we found their productivity far below that of other organizations providing similar services, including other public sector organizations. For example:

- in 1990 we found Canadian Forces hospitals whose costs were 86 percent higher than civilian hospitals of a similar size;
- the same year we also found that departmental technical schools were much more costly than civilian community colleges; and
- in 1994 we found that the productivity of construction engineering tradespeople was 33 percent lower than in the private sector.

34.11 In 1994, we also completed an audit of the central management systems in the Department. We found that the Department had recognized the importance of managing its costs and had begun to implement “business planning” to increase managers’ focus on objectives and to become more efficient. But managers lacked necessary information and there were few incentives to minimize costs. The lack of information has delayed cost-saving initiatives.

The Department made a commitment to renewal

34.12 The Public Accounts Committee held hearings on our 1994 Report chapters. In testimony to the Committee, senior departmental officials described their organization as bureaucratic and risk-averse. They told the Committee that “truckloads” of regulations had developed over the years. Rules were so extensive that “Mickey Mouse could have been a

Senior management has made a commitment to improving business practices and thereby to improving productivity.

[Base Construction Engineering Officer] if he could read, because [the regulations] told him every conceivable thing he could do and could not do.”

34.13 Officials described their renewal efforts as based on two projects: business planning and operating budgets. The Department intended to use business planning to link results to resource use, and operating budgets to delegate more resources to local managers and allow for greater initiative and flexibility. Local managers were to change from “resource custodians” to active managers. Senior officials said that this would allow the Department to lower overhead, maximize efficiency and simplify service delivery. They believed that this change would be complete in five years, or by 1999.

34.14 In its report, the Public Accounts Committee expressed scepticism that the Department’s proposed efforts would be adequate or timely enough. In particular, the Committee called on the Department to develop cost information for

management decisions and to track the results of its cost reduction initiatives. The Committee also requested the Auditor General to track the Department’s efforts to reform its management structure and practices, and to report to the Committee as appropriate. This chapter provides a report at the two-year point for the Committee.

Program Review made large budget cuts

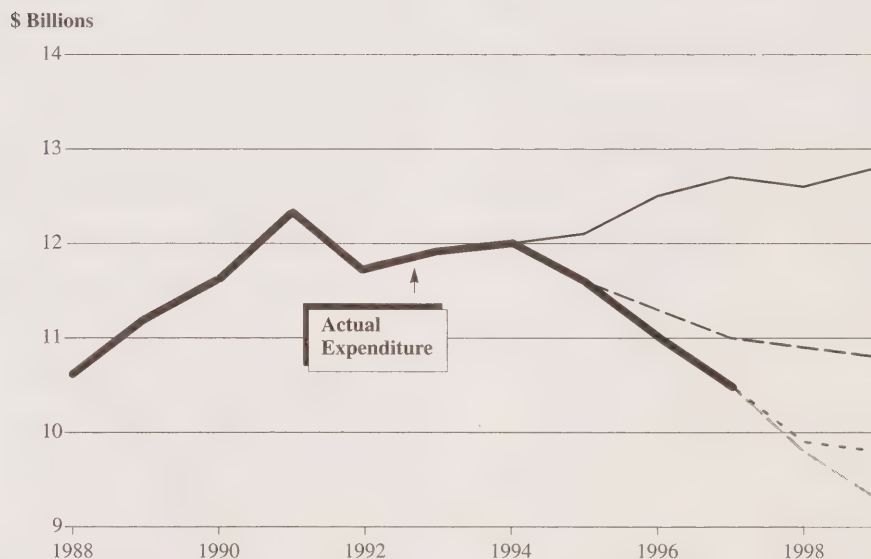
34.15 Large budget cuts have made it imperative that the Department begin renewal efforts, but have also made it a complicated task. In order to meet deficit reduction targets and to take advantage of the end of the Cold War, the government has greatly reduced the defence budget. Defence spending is projected to fall from about \$12 billion a year in 1993–94 to \$9.25 billion in 1998–99 (Exhibit 34.1). The Department intends to cut costs by closing bases, reducing by up to 50 percent the resources consumed by major headquarters, reducing support functions by 15 percent by the end of

Exhibit 34.1

Defence Spending, 1988–1998

Defence spending has fallen.

Budget '93 —————
 Budget '94 - - - - -
 Budget '95
 Budget '96 ————



Note: Actual and forecast from Part III of the Estimates. Budget numbers are from various internal DND forecasts and plans.

1997, and reducing staff at bases and commands by 15 percent by the end of 1997. This process is well under way.

34.16 Budget reductions, the loss of many personnel and the accompanying turbulence have placed a significant burden on management. The Department has been successful in reducing its expenditures and work force by the required amounts. The success of its renewal efforts must be seen in the context of these very large cuts, the effort required to manage them, and the complications of trying to implement renewal in the middle of a program of directed cuts and downsizing.

The Department has recovery initiatives to improve productivity

34.17 As early as 1991, National Defence began to implement initiatives to improve productivity:

- The Base Delegation of Authority (DelegAAT) initiative begun that year was aimed at delegating greater authority and increasing accountability for resource management by base commanders. The Department tested DelegAAT at three bases and communicated the results across the Department.

- Defence 2000 was launched in 1992 to co-ordinate all renewal initiatives, place them within a strategic framework, and make renewal a priority within the Department. Emphasizing “service, empowerment, innovation and accountability”, it generated a number of renewal and re-engineering initiatives at the command and base levels.

- Operation Excelsite was begun by the Assistant Deputy Minister (Materiel) Group in 1994, to achieve major improvements in the cost effectiveness of

materiel operations while providing the same level of service.

- Operation Renaissance, begun in January 1995, is a re-engineering effort of the Assistant Deputy Minister (Personnel) Group, similar to Operation Excelsite.

- The Management, Command and Control Re-engineering Team (MCCRT) was intended to rationalize National Defence Headquarters and the various command headquarters, reducing their cost by 50 percent. MCCRT has become the departmental umbrella program co-ordinating all the major re-engineering and renewal efforts, including Defence 2000, Operation Excelsite and Operation Renaissance.

Where is it now?

34.18 The Department has had initiatives in place for five years and began its major renewal effort two years ago, in 1994. The objective of our audit was to identify progress achieved so far, and this chapter reports our findings. Further details on our audit objectives and



The Department is on schedule in reducing the resources required to run major headquarters (see paragraph 34.15).

scope can be found at the end of the chapter.

Observations and Recommendations

Corporate Management

Change initiatives are difficult to control

34.19 Change needs to be managed.

In order to manage a turnaround in an organization as large and diverse as the Department of National Defence, managers must deal with at least three different levels of change:

- They must manage the change of entire national systems — such as the personnel system or the supply system — to select the best overall strategy for providing support.
- They must decide how to adapt national systems to local circumstances to ensure that specific requirements are met in the most cost-effective way.
- They must ensure that they themselves adapt to new ways of doing business and adapt their beliefs and values to the corporate culture.

34.20 National Defence is now facing a tremendous challenge as it attempts to change national and local systems simultaneously, through 15 major initiatives and thousands of local initiatives. In addition, the Department is attempting to make a significant change in its work culture by trying to move from a rule-following, risk-averse “custodial” past to a more entrepreneurial “business” approach in the future.

34.21 We expected, therefore, that the Department would have structures in place to manage and co-ordinate change.

Although the Department does have a structure in place, our audit indicates that the management of change needs to be improved.

34.22 The Department needs to improve co-ordination. The Department adopted a philosophy of attempting to incorporate change within its existing management or “command and control” structure. It placed its emphasis on facilitating improvement and removing roadblocks rather than relying on central control. Central control itself was regarded as the root of many existing problems.

34.23 However, by 1995 the Department concluded that its approach, allowing a large number of individual projects, would work better if there were a single co-ordinator of these efforts. The Department’s renewal structure begins at the top with the Deputy Minister, the Chief of the Defence Staff and their senior management team. A Management, Command and Control Re-engineering Team (MCCRT) co-ordinates re-engineering teams that are active in all major sectors of the Department. The Department is devoting 110 full-time personnel to MCCRT projects.

34.24 A second major co-ordinative effort is Defence 2000 (D2000). The Department set up this office in 1992 to co-ordinate overall departmental renewal initiatives, place them in a strategic framework, and make renewal efforts a priority within the Department. It is a major corporate initiative that emphasizes “empowerment, innovation, accountability and service.” Many command-level projects have begun under D2000. Specific targets for improvement include:

- planning, budgeting and accountability processes;

- Department-wide materiel, financial, personnel, information and general administration systems;

- the work processes and structures employed by units to achieve their missions; and

- leadership priorities.

D2000 work is co-ordinated by the Chief of Management Renewal Services, and all major organizations have a D2000 cell. The responsibility for both re-engineering and renewal work remains with line managers, who must ensure that changes are implemented.

34.25 We met with senior officials in July 1996 to obtain information on the plans and progress of the MCCRT initiatives. Officials told us that coping with budget and personnel reductions has been a major focus of efforts so far. The Department has been able to attain its objectives for base closures and for the reduction in the size of its major headquarters. Officials noted that they had identified personnel reductions of 45 percent in National Defence Headquarters, exceeding the 33 percent target set in the 1994 White Paper.

34.26 Major renewal projects, however, are still at a “conceptual” stage. MCCRT will end in 1997. Senior management has directed MCCRT to provide a strategic plan by the end of 1996 to address co-ordination requirements and the future role of the Chief of Management Renewal Services. These jobs may well be done in the future by one organization.

34.27 In some areas, personnel are confused by the many overlapping and duplicative renewal efforts. According to a survey done by Air Command, there are so many national, functional, and command projects that duplication is resulting. There appears to be some

confusion regarding the demarcation of responsibility among the various levels of command.

34.28 Some initiatives suffered delays.

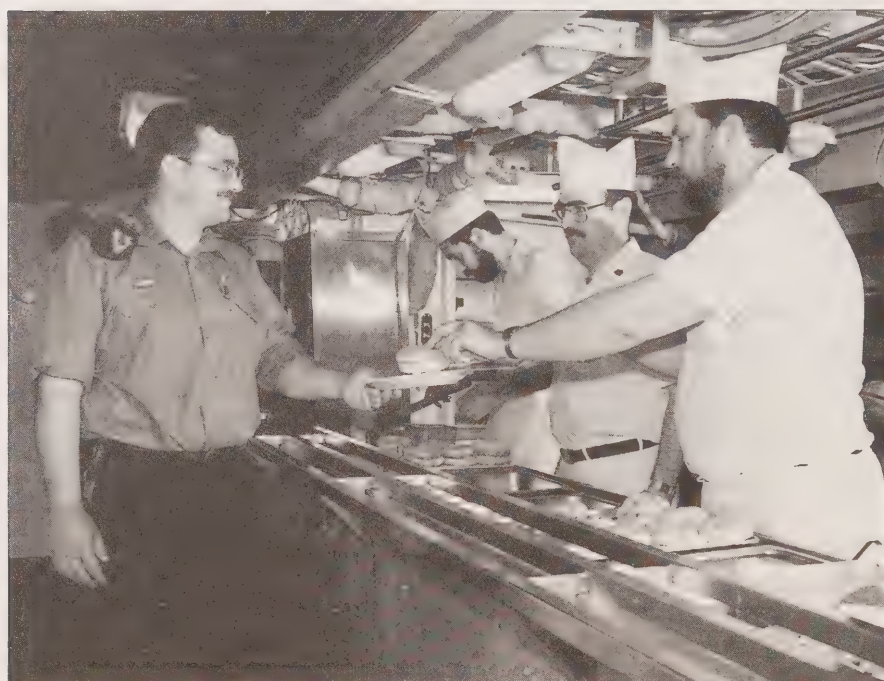
We found that several initiatives have been delayed because of unclear or divided accountability and lack of cost information. For example:

- **Red Tape Action Team.** The Department established the Red Tape Action Team in 1994 to reduce the numbers of directives and procedures by 50 percent. The project was originally intended to be completed within two years and it has been successful in designing a new policy generation process. Due to overambitious objectives, the difficulty of the task and reordering of priorities, officials estimate that the project will take an additional 15 months to complete.

- **Military pay.** The Department’s military pay system produces salary payments for its 69,000 military members. In 1994 a departmental study indicated that the military pay system was inefficient, requiring more people than necessary to operate. A subsequent internal audit confirmed that at least \$14 million a year could be saved by re-engineering the military pay system. The Defence Management Committee approved re-engineering in principle in September 1995. However, the initiative is dependent on other technology and human resource projects and the Department has not established a firm timetable for achieving savings. The Department is also evaluating the potential for contracting out military pay services to the private sector. Officials could not tell us exactly how the Department would meet the target of a 50 percent reduction in the personnel who provide military pay services.

- **Food services.** In 1994 the Vice Chief of the Defence Staff ordered staff to investigate the possibility of using the private sector to provide food services to the military. In March 1995, staff completed their study and in October 1995

Initiatives to improve the productivity of pay and food services have been delayed (see paragraph 34.28).



three bases were selected for trials. The lack of a costing and evaluation policy to allow a fair comparison between departmental and private sector alternatives has delayed action. In July 1996, officials were still developing a new costing model to assess the private sector alternative.

34.29 Base DelegAAT has been a success. The Base DelegAAT project was intended to assess the impact of giving base commanders increased authority for resource management. After the pilot project demonstrated that significant savings could be made through greater delegation of authority, best practices were communicated throughout the Department.

34.30 We selected the Base DelegAAT initiatives that had reported the largest savings — \$100,000 per year or more at a single site. We wanted to see whether managers on other bases had heard of these savings opportunities and whether they had used them on their bases. We contacted 19 bases and spoke to officials in charge of specific functional areas or of change initiatives overall.

34.31 We found that while only 30 percent of the responsible managers had learned of relevant initiatives directly from Base DelegAAT communications, about 53 percent had become aware of initiatives through conferences, by word of mouth or by chance. Another 8 percent had “reinvented the wheel” and come up with the same idea locally. Almost 40 percent had implemented related ideas and another 46 percent were either beginning implementation or considering it. The individual managers we talked to had documented annualized savings of almost \$12 million. This is more than the savings claimed by the Department in the Main Estimates.

34.32 National Defence should ensure that it maintains a centre for the co-ordination of change. The centre should continue to track the activities of major initiatives, address common problem areas, and report to senior management. In addition, it should continue to ensure that procedures are in place to communicate information on best practices and bring any delays or conflicts to the attention of senior management.

Department's response: The Department is still in the relatively early stages of major change, which is intended to take place during the period from 1994 to 1999. This is considered to be a realistic timeframe to achieve the essence of fundamental transition. Positive results are only now starting to be realized, at about the two-year point. This monumental re-engineering and restructuring demands strong leadership as well as commitment of resources.

The Department strongly supports this recommendation and has every intention of maintaining proper co-ordination of change activities. This will probably be a role for the Chief of Management Renewal Services organization of the future. The foreseen requirement will be to exploit cross-functional lessons learned, identify and resolve common problems, and assist senior management in keeping the renewal initiative on track. It is not currently our intention to create or promote centralized control of change initiatives. This work is rightly the responsibility of those in the chain of command. Accordingly, any corporate-level, centrally focussed organization will adopt a co-ordination, harmonization and facilitation role. It is intended that the mandate for such an organization will be established so as to enable it to take over from the MCCRT when the latter reaches its termination date during the summer of 1997.

The change in values and beliefs has just begun

34.33 As already noted, the Department believes that it must alter its work culture in order to increase its productivity. Senior officials told the Public Accounts Committee in 1995 that the Department up to that point had been “very centralized . . . very hierarchical and . . . risk free We lived in an environment where we thought there were two ways of doing things: our way and the wrong way.” As a result, there had been a proliferation of rules and regulations to remove “the burden from individuals in terms of devoting a lot of time to management.” All individuals had to do was “pull the book out and the book [would tell] them what they [had] to do in a step-by-step manner.” The Department had “a regulation for every mistake that’s been made in the Canadian Armed Forces or the Department for the last hundred years.”

34.34 Changing attitudes and beliefs is an extremely difficult task. Some organizations believe it to be so difficult that they practise a “greenfields” approach. That is, rather than attempt to change the values of their existing labour force, they will build a new plant and staff it with new employees — sometimes from outside their industry. One international airline adopted this approach to implement a new concept in the repair and overhaul of aircraft equipment.

34.35 The Department has undertaken four major surveys to find out the attitudes of its military and civilian members. Two studies — one undertaken by the Personnel Group and the other by the D2000 project — were comprehensive, in that they included the entire Department. The other surveys were aimed at members in Materiel and Training. The smallest

survey — Training — met all our methodological standards, in that it was based on a validated model with pretested questions, used random sampling and a sample of adequate size, had an adequate response rate and produced results that could be compared with results from other organizations. The D2000 and Materiel surveys were generally adequate, but were unique studies and could not be compared with those of organizations outside the Department. The Personnel study was not based on a theoretical model, questions were not pretested and the response rate was poor. All the surveys were undertaken in 1995 except the Training survey, which was completed in 1996.

34.36 The results of the four studies are highly consistent and, in spite of the limitations noted above, provide valuable information. The three largest studies show that the civil/military “defence team” accepts the need for change and does not want to continue working in the same old way:

- Most people appear to believe that they personally can cope with the required changes.
- Most believe their colleagues are dedicated and motivated to do a good job and that their units are operating well.
- Most members appear to have a high level of commitment to their Department.

34.37 However, the surveys point to problems that the Department will need to work to overcome:

- Results show that in one group the majority believe that the changes desired by management go against individuals’ strongly held beliefs, even though the majority in that same group said they are looking forward to new ways of doing business and do not want to continue the status quo. In another group, the culture is contrary to one that can support high performance, respond to change or

achieve change. A Department-wide study indicated that the great majority support the new management values but that, to many, the relationship between military values and the new values is unclear.

- All the studies indicate that there is a lack of confidence and trust in leadership. One study indicates that about one third believe that civilians and the military work effectively together, another third are neutral and the final third believe that they do not work well together. One survey places overall co-operation and collaboration among a large group of employees at “rock-bottom” levels.

- The data show that there are difficulties in putting the new management principles into place. While most people say they support the principles, management programs aimed at implementing them are regarded as seeking only cuts rather than seeking to improve program delivery. Only 27 percent of the respondents in one survey said the new management principles were being acted on in their units.

- There are continued concerns about bureaucracy and rules and procedures that impede efficient use of resources.

34.38 National Defence has taken commendable steps in coming to grips with the problems of changing values and beliefs. The survey results show, however, that the change process has just begun. They also provide warning signs that the process may be long and difficult, and that it will require persistent and credible leadership at all levels to succeed. As of June 1996, a “cultural awareness package” had not yet been completed or approved by senior management, but officials told us that work was in progress on this and other initiatives. The Department is evaluating recommendations made by a joint civilian-military all-ranks group. Air Command has delivered a three-day

awareness program to most of its personnel.

34.39 Officials noted that due to restraint, they have been unable to establish many incentives to promote improved performance. A Deputy Minister/Chief of the Defence Staff recognition award has been put in place, but otherwise the scope for action is limited. Even allowing local managers the opportunity to use part of savings to meet local needs has been curtailed by the need to make cuts and reduce the departmental budget overall.

34.40 We believe it would be useful for departmental and Treasury Board officials to further discuss incentives for managers to improve productivity.

34.41 **National Defence should continue to monitor those employee beliefs and values on which its new management system depends. It should strengthen measures to ensure that management systems support the desired culture.**

Department's response: The Department concurs with this recommendation. It has always been our intention to continue to monitor employee beliefs and values on which the new management system depends. The D2000 Survey instrument was specifically designed with this purpose in mind, and it is planned to re-administer it in 1998 or 1999 as a measure of cultural change progress.

Overall, the surveys indicate that the Department has been able to impart to the Defence team the values underlying renewal. The issue now is to address the deficiencies in those areas that are required to facilitate the implementation of these accepted values. The following areas need attention: trust and confidence between management and staff at every level; reduction in bureaucratic procedures; the manner in which the Department communicates internally; and

the stress levels and morale of members of the Defence team.

Efforts also will continue to translate our management principles into practice through changes to management systems and through cultural change activities. The culture has begun to evolve as a result of the re-engineering effort and this evolution will continue as practices such as business planning become more solidly institutionalized. To reinforce this evolution, corporate-level change initiatives will include cultural transition support and an ethics program complementing command and group-level efforts. One very significant example is the three-day session being delivered to Air Command personnel as part of that command's "Flight Plan 97" work.

"Business plans" often lack cost and output data

34.42 According to the Treasury Board, "business planning" is intended to help departments adjust and manage with fewer resources. National Defence defines business planning as an accountability-based process that links activities to

performance through contracts between superiors and subordinates. These contracts identify tasks to be performed, the assigned resources and the expected results. The key elements of business planning, therefore, are cost and performance data on which to base a contract.

34.43 In previous audit reports we had noted deficiencies in the information available to senior management for decisions and in reporting on operational readiness. Departmental officials responded that business planning would address these deficiencies and would resolve accountability problems. Officials have described business planning as a "key tool" of their renewal efforts.

34.44 At the time of our present audit, the Department had only its highest-level business plans in place — those at the command and headquarters group levels. The Department has since begun a second cycle of planning, extending business planning throughout groups and commands. We examined the high-level

Exhibit 34.2

Assessment of Business Plans

Business planning is not yet adequate.

Criteria	Navy	Army	Air Force	Personnel Group	Materiel Group	Finance Group	Info Tech Group
Business Lines Defined	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Activities Defined	Yes	Yes	Yes	Yes	Partial	Partial	Yes
Intended Results Defined	Partial	Yes	Yes	Yes	No	No	Yes
Costs Defined	Partial	Yes	Partial	Yes	No	No	No
Priorities Set	Yes	Yes	Yes	Yes	Partial	Partial	Yes
Sets Out Factors that Affect Results	Partial	No	No	Yes	Yes	Yes	Yes

plans to see if they adequately described activities and objectives, linked costs to objectives, had performance measures and set priorities. We found that progress had been made, and that four of seven plans were satisfactory in most respects. Our results are summarized in Exhibit 34.2.

34.45 Nearly all the business plans describe activities well, but three of the seven lack a description of the intended results. The Department's Operational Readiness and Effectiveness Reporting System, which we found deficient in 1994, is no longer used to report to National Defence Headquarters and a new system is under development. The cost of activities is also frequently missing from business plans. In addition, we found that the Department has not yet approved the funding for its project to create a "data warehouse" to act as a central repository for business planning data.

34.46 Overall, we noted strong effort and some progress in creating business plans. Much effort has been expended on defining activities and objectives, which should provide a valuable base for future efforts. However, until business plans include cost and performance data they cannot act as a tool to improve productivity.

34.47 National Defence should develop and make available cost and performance data to support business planning. It should establish dates by which such data are to be available at each planning level.

Department's response: Developing and making available cost and performance data have been and continue to be priorities in implementing business planning within the Department, and work is well under way on both fronts.

Efforts to cost activities in support of business planning are being pursued

through the establishment of a financial and managerial accounting system, of which activity-based costing (ABC) is only one component. Pilot projects are under way in Land Forces Command, Air Command, Assistant Deputy Minister Defence Information Services, Assistant Deputy Minister Materiel and Assistant Deputy Minister Personnel. As well, a Management Accounting Working Group (MAWG) has been established to address ABC at the national level. At present, the MAWG is conducting an evaluation of a commercial off-the-shelf system to determine whether it has the potential to meet our financial and managerial accounting needs. The plan would then be to conduct a pilot project in one of the groups, to be complete by December 1997. If successful, DND would implement the new system Department-wide by June 1998.

In the area of performance measurement (PM), the most significant progress has been achieved through the issue of strategic PM guidance in Defence Planning Guidance (DPG) 97, to be published in October 1996. Chapter 5 of that document clearly describes the overall PM system and presents a "strawman" framework against which performance should be measured. The framework captures the first attempt at identifying the critical success factors, performance measurement areas, and (to a lesser degree of completeness) performance indicators for each of the five National Defence strategic objectives. This guidance is presented not only to condition the concurrent PM development already under way in the commands and groups, but also to generate the feedback necessary to better define the performance indicators and yet-to-be-developed strategic standards. This iterative process will complete the development of a DND PM system that will generate the raw performance data that, once analyzed, will assist in strategic decision making. It will also provide the inputs required for reports to government. One significant

The two key tools of business plans and operating budgets in the Department's renewal process have proved to be necessary to improve productivity, but not sufficient.

performance reporting initiative is the ongoing development of the Resource and Capability Report (RECAP). A prototype of RECAP, potentially a replacement system for ORES, is due for presentation in the November–December 1996 timeframe. Built around capabilities, this new system is intended to fit with business planning and extend the functionality of ORES into new areas. In summary, the PM guidance contained in DPG 97 is expected to produce a partially mature PM system for FY 1997–1998.

Operating budgets have had limited impact so far

34.48 The second key tool in departmental renewal is the use of operating budgets. Treasury Board directed departments to have operating budgets in place by April 1993. National Defence operating budgets include civilian personnel, operations and maintenance funds and capital delegated to managers at commands and bases. The intent behind operating budgets is to allow local managers the initiative to make their operations more efficient by making their own spending choices among minor capital items, personnel and operational activity. A wing commander, for example, could choose to have fewer workers cleaning buildings and more fuel for his aircraft.

34.49 In 1995, senior officials told the Public Accounts Committee that the delegation of funds to base commanders was well under way: 40 percent of the resources they used were under their control and up to 60 percent might be possible in the future. They told the Committee that this would allow local-level managers to make decisions giving greater weight to factors that, although important to sound resource management, tend to be invisible to management at higher levels.

34.50 We reviewed the delegation of funds to local managers to see what had been achieved. We found that the Department has almost achieved its targeted delegation of 40 percent of budget. The two largest National Defence Headquarters groups, Personnel and Materiel, were greatly affected by downsizing and reorganization and have yet to finish implementing operating budgets. Most Headquarters managers believe the delegation of budgets has been beneficial, but no evaluation has been conducted yet.

34.51 We also examined whether the delegation of funds to local managers had resulted in changes in the resource mix used to provide support services, as the Department had originally anticipated. We contacted base maintenance, supply and transport managers at the 22 bases used in our audit; 21 bases responded. We found fewer than half of the managers had transferred money from their personnel account to other accounts. Comments from local managers indicated that most savings from local initiatives have been used to meet the need for budget reductions. Local managers have been forced to reduce their civilian work force and have had little opportunity to use operating budgets to make their operations more efficient.

34.52 We found that in spite of the pressures of budget reductions, net transfers of funds from civilian pay accounted for \$38.1 million in 1994–95 and \$64.5 million in 1995–96. Officials told us that even though military pay is not yet part of operating budgets, managers will be able to convert military positions into cash when force structure and funding issues are resolved. Officials also said that funds transferred from operations to capital have been used, in large measure to buy information

technology in order to reduce personnel and increase productivity.

34.53 While it is clear that some managers are making good use of the flexibility of operating budgets, documentation we reviewed indicated a lack of awareness of discretionary powers to transfer funds. It appears that lack of knowledge in some areas about how to make budget transfers may have inhibited change. Our conclusion is that operating budgets are indeed a useful tool but that their full utility has not yet been realized at the local level.

34.54 National Defence should ensure that managers know how to use operating budgets and should provide them with incentives to do so.

Department's response: National Defence recognizes that in order to continue to meet policy commitments with fewer resources, managers must have the flexibility that is inherent in operating budgets. While information on operating budgets has been promulgated, action will be taken to confirm whether this information is reaching managers in a timely and effective manner, and to rectify any shortcomings. The Department believes that a smoothly functioning system of operating budgets offers flexibilities that are a significant incentive to well-informed managers.

Base Management

What is a base?

34.55 Bases are centres that exist to support operational units of the Canadian Forces, the Reserves, schools and all other departmental activity in their vicinity. Bases provide a generally common range of services for which National Defence Headquarters establishes standards, policies and management systems. Staff at National Defence Headquarters also

establish the personnel policies that govern individual skills and set overall resource levels for commands and headquarters groups.

34.56 The Canadian Forces have 29 bases across Canada. The largest is Halifax, with a staff of 2,114, while the smallest is Moncton with a complement of 182. Each year about \$2 billion dollars or 24 percent of the Department's operating budget is consumed by bases; about 26 percent of National Defence personnel work in base support. Our audit focussed on the 22 bases that the Department intends to keep open. The bases we selected represent about 82 percent of the Department's spending at the base level. We selected three base support functions for audit: supply, transportation and maintenance (focussing on maintenance of vehicles).

Much remains to be done to create a businesslike workplace

34.57 As noted above, a major renewal goal of the Department is to change from a rule-following, risk-averse bureaucratic workplace to one that is more businesslike. In the new workplace, managers would be sensitive to cost and efficiency, able to assess costs and benefits and able to exercise initiative. We asked the managers of supply, transportation and maintenance at the 22 bases covered by our audit about progress in this area. Twenty-one bases responded. From their replies, it appears that much remains to be done.

34.58 The majority of base managers reported that they have more control of and accountability for the resources their sections consume. However, over half told us that inflexible personnel regulations limit their ability to manage in a more businesslike way. They were especially concerned about limits imposed by regulations governing civilian employees

The Canadian Forces have 29 bases across Canada to support operational units. They consume \$2 billion a year (see paragraph 34.56).



and, to a lesser degree, by those concerning military personnel.

34.59 Thirteen percent thought the availability of cost information had improved through the introduction of the Cost Centre Management Project, an Air

Command initiative to provide comprehensive resource information to its local managers; 32 percent attributed the improvement to the Consumer Consumption Awareness initiative, a second initiative to let consumers know

the cost of supplies drawn from the Canadian Forces Supply System. However, only 5 percent of the base managers said they could now get all the relevant information they need when they need it. The Cost Centre Management Project appears to have been abandoned by all but Air Command. Officials told us the Department has recognized the need to improve the availability of cost information and is working on several projects. The Department recognizes a need for better co-ordination of cost information projects and work has begun on a Departmental Management Accounting System to support financial and managerial accounting, business planning and performance measurement.

34.60 Performance management information, however, is still almost totally lacking. Managers knew what their outputs were, and knew where to find output data. However, only 27 percent had attempted to cost their outputs, and only one could give an example of having done so. Seventeen percent had defined a level of service to be provided to customers and 19 percent had done customer satisfaction surveys. No one on the 21 bases responding reported having a computer-based performance management system, and only 43 percent said they had any performance indicators at all. Six percent had made some attempt to benchmark themselves against providers of similar services.

34.61 Seventy-two percent of the base managers we talked to had begun a re-engineering project. More than half had not completed their project and, in most cases, could not provide a completion date.

34.62 It appears that progress is occurring at the level where most work is done. Cost information has not improved substantially since our 1994 audit,

although managers want better cost information. Red tape is still a problem. Performance information is seriously lacking. The impact of these deficiencies is reported below.

The productivity of base supply has not yet begun to improve

34.63 Base supply receives, warehouses and distributes all the materiel required by operational units, support units and the base itself. Materiel ranges from office supplies to weapon system components. Most supplies are managed through the national Canadian Forces Supply System, which acquires, provides and accounts for military and specialized materiel. The majority of common commercial items are purchased by the base directly from suppliers. At our sample of 22 bases in 1995–96, base supply employed 2,613 of the 3,497 people employed by the total Supply System, handled 2.6 million orders and cost \$99 million in wages to operate.

34.64 **The Department recognizes its deficiencies.** National Defence recognizes that its current supply system is inefficient, and has already begun improvements. Studies at the base, command and national levels show that changes are required and that savings of up to 40 to 50 percent of 1994 baseline costs may be possible. The Department has made policy changes, and officials believe that costs will be greatly reduced by procuring commercially available items locally. The Department is streamlining bureaucratic management processes.

34.65 **Three bases have made improvements.** We found that many bases are attempting to improve their efficiency and three bases in particular have made significant improvements. Canadian Forces Base Esquimalt, for example, which services the navy on the West Coast, has cut from 120 to 17 the number

Progress toward a businesslike workplace has been slow on Canadian Forces bases because information and incentives are lacking.

Reductions in supply personnel have not kept pace with the reduced demand for service. Officials believe this is a transitional problem.

of steps required to process certain orders, and has reduced related staff to one third of its former requirement by simplifying work and using just-in-time delivery from local suppliers (Exhibit 34.3). CFB Halifax and 17 Wing (Winnipeg) have also demonstrated productivity gains.

34.66 Overall, the Department has reduced personnel but productivity has fallen. We conducted our own analysis of supply services provided at the base level. We reviewed transaction and personnel data from 1992–93 to 1995–96. We found that, in spite of departmental initiatives to improve productivity and reduce the number of personnel in supply, there has been no overall improvement. The labour cost of filling an order at the base level increased from \$27.46 to \$33.23. When wage increases are taken into account, this equates to a 10 percent decline in productivity. The number of orders handled by each base supply employee fell from 1,295 a year in 1992–93 to 1,168

in 1995–96, a decline of 10 percent. Officials believe that they are in a transitional period in which gains from changed processes have not yet been realized. While the effects of personnel reductions and decline in activity are visible, savings due to re-engineering and restructuring have yet to materialize.

34.67 Productivity measures are lacking. We found that the information we required for our study was not available at the base level; computer downloads to provide data from the national level require months of effort. We also noted that the Department does not take into account management practices that affect productivity statistics, such as borrowing personnel from operational units. When additional labour is used but not recorded, productivity measurement is distorted. Similarly, systems in place do not record military overtime. While Canadian Forces members are not paid for overtime, if overtime hours are not recorded it is impossible to say whether changes to the system are actually reducing the amount of labour required. This creates a risk that cost savings predicted by the Department for future changes may be overstated.

34.68 National Defence should move as quickly as possible to communicate information throughout the entire Department on the improvements achieved by the three most successful bases.

Department's response: The Department fully agrees that effective communication is essential for success and will continue to pursue an aggressive communications plan. Individual and corporate initiatives have included quarterly and annual best practices workshops, re-engineering papers, studies and briefings to co-ordinate and communicate the "way ahead" down to the base and unit level. Moreover, our corporate re-engineering authority (MCCRT) has already profiled

The productivity of base supply declined 10 percent between 1992–93 and 1995–96 (see paragraph 34.66).



CFB Esquimalt as a leader in re-engineering. Its example is being used as a model for the major re-engineering efforts under way in the Department. In fact, the Base Supply Officer of CFB Esquimalt was a key member of the MCCRT re-engineering team and has made presentations at various re-engineering and business process review conferences across the country. Also, almost every major base has visited Base Supply at CFB Esquimalt. This type of information on improvements will also be officially communicated as part of the Materiel Support Team Implementation Plan due out in fall 1996. As part of the MCCRT communication strategy, re-engineering initiatives such as those undertaken by CFB Esquimalt were also presented to the Assistant Deputy Minister (Materiel) community in various newsletters. In addition, Chief of Management Renewal Services (CMRS) has prepared a best practices diskette that is widely distributed throughout the Department.

34.69 National Defence should monitor transaction costs and volumes per employee as indicators of performance. Performance data should be readily available to managers.

Department's response: It is fully agreed that relevant performance data and indicators are a fundamental element of the materiel management and operation of the supply system. Transaction costs and volume per employee are important indicators and will be included in the package of performance measurement criteria that is being developed. It should be noted that there are several other indicators that are important and that must also be considered, including customer satisfaction, turnaround times, unit distribution costs, operational effectiveness, operational readiness, and ability to execute military plans. Performance measurement is an important deliverable in the re-engineering and

business process reviews that are currently under way. It is also an essential component of the Canadian Forces Supply System Upgrade Project, with particular emphasis on the identification of relevant performance criteria and the availability of performance data for managers.

The number of kilometres driven in transportation sections varies widely

34.70 Base transportation provides local transport for passengers and cargo. It also operates special-purpose vehicles such as forklifts and snowploughs. The Department has over 9,200 civilian pattern vehicles in its fleet. Cars and light trucks account for about half of these vehicles. It assigns operators based primarily on "dispatched hours", or the total time vehicles are checked out, and supervisors based principally on the number of vehicles held by an individual base. Work is considered to be specialized, and drivers generally do not operate vehicles except the types held by their own sections.

34.71 Two bases have improved. The Department has streamlined transportation operations on two bases, Suffield and Montreal. Management at Suffield, with the assistance of a National Defence Headquarters re-engineering team, reduced the need for drivers by analyzing customer requirements and finding less expensive ways to meet their needs. Managers made processes more efficient or found alternative means of providing service. They reduced costs by:

- adopting a user-drive policy for passenger cars;
- discontinuing commuter and shift buses and providing soldiers and employees with a commuting allowance; and
- giving the vehicles to the base functions requiring them rather than

Exhibit 34.3

CFB Esquimalt Supply Case Study

Successful re-engineering

Background

In early 1994, the Base Supply Officer at CFB Esquimalt requested the assistance of the National Defence Headquarters Base Delegation/Defence 2000 Project Office to re-engineer the local procurement of commercial goods. At the time, the base was not facing any fiscal pressure from budget cuts or policy changes. The project was initiated simply to improve the efficiency of base supply and to improve the quality of service provided to its customers. The Business Process Re-engineering Team concluded that contracting out the local procurement of commercial goods could result in annual savings of approximately \$6 million. It also concluded that adopting new inventory concepts could result in annual savings of \$5.2 million. The Team opted for the gradual downsizing of the workforce.

Local Supply Before Re-engineering

Before 1994, supply used 76 people to handle local procurement, record keeping and distribution of all items used by the 50 to 60 units on the base. The section had an annual budget of about \$25 million. Before re-engineering, stocked inventory was valued at about \$15 million and was spread out across six warehouses or Supply Account Code areas. There was no single contact point for all items and only 10 percent of all orders could be filled from inventory due to frequent stockouts. Stocking policy was based on predetermined stock levels and not on usage patterns. Due to this lack of prioritizing, some goods sat on the shelf for years, while others were never there. The process of ordering an item was immensely inefficient and very time-consuming due to the numerous steps involved when a good was not in stock, which was 90 percent of the time. Often orders could take a very long time to arrive due to both the process itself and the fact that the procurement orders of senior officers always took precedence over the basic needs of other units.

The Re-engineering Project

Base supply's re-engineering plan for local procurement used a five-step process. First, the section was to devolve budgets to the local units. Second, supply was to provide sourcing options so that units could make their own purchases. This involved the implementation of a credit card system, direct delivery and the reorganization of supply into a more customer-oriented organization. The third step was to create this new organization through staffing changes. This involved the creation of teams made up of case workers (buyers) and cross-dockers (shippers and receivers) who would assist units on request. The fourth step involved a reconsideration of local supply storage policy. The section would no longer stock local supply items and would assess the current stock status so that such items could be "put on sale" and eliminated. The fifth step was to continuously evaluate the process and to examine new areas where base supply could add value to the area of local supply.

Conclusion

The initiative succeeded and is now available as an excellent benchmark for efficiency and cost effectiveness for all base supply sections. It resulted in a more streamlined organization. Base supply was able to reduce local procurement personnel from 76 staff to 27 with the expectation of eliminating five more once the concept of direct procurement takes hold among the units. Case worker negotiations with suppliers resulted in a \$9,000 drop in shipping costs alone. The fourth step was estimated to have freed up about 30 percent of the warehouse space on the base through reducing inventory value by \$15 million.

The Esquimalt supply re-engineering initiative has created a system in which individuals no longer have to bend or skirt the rules for the sake of efficiency. The section has created clear and logical lines of responsibility and has defined a new role for itself that includes a greater commitment to customer satisfaction and continuous internal examination and improvement. Exported throughout the Canadian Forces, these practices could result in a more efficient national supply system and higher savings for the Department of National Defence as a whole.

letting base transportation manage the vehicles.

The Department has saved over \$2 million per annum through these changes.

34.72 Since April 1996, process re-engineering efforts at Base Montreal have resulted in a reduction in overhead personnel from 0.4 to 0.24 overhead staff per driver. Base staff achieved this by eliminating some supervisory levels and all dispatcher positions. The base transportation officer estimates that the productivity of drivers on the base will more than triple as a result of the 1996–97 personnel changes, from 9,196 to 30,420 kilometres per driver annually. Further projected reductions in the number of drivers is expected to increase this figure to 35,635 kilometres per driver annually by September 1996.

34.73 Our audit shows great differences from base to base in the number of kilometres driven. Our audit compared the average number of kilometres driven per driver at each of our 22 bases. This indicator is a commonly used statistic in the industry and provides insight into the amount of work completed. While these were the only data available at the time of our audit, it should be noted that full measurement of transportation productivity would require several indicators. Our analysis included 1,400 drivers during 1995–96, the only year for which data were available. Results are shown in Exhibit 34.4.

34.74 We found that drivers on the best-performing base drove an average of 21 times farther than drivers on the lowest-performing base. The average of the best five bases was 5.6 times farther than the five lowest-performing bases. The average distance driven by an individual per day ranged from 12 kilometres per day on one base to 259

on another, with a fleet average of 97 kilometres per day.

34.75 Officials suggested that the average number of kilometres driven could be affected by the quality of roads, weather, the number of units and personnel served, the type of driving done, the type of military units served and the overall number of base staff. We found no correlation between productivity and these factors. We concluded that the differences are linked to management factors rather than the type of work or environmental factors. We also concluded that the policy for determining the number of drivers required by a base is inadequate. Officials have told us they are reviewing the policy.

34.76 Supervision and overhead costs are high. We also examined the levels of staff assigned to supervisory and overhead functions related to transportation. Again, we found a wide range among bases, from one overhead employee for every seven drivers to more than one for each driver. Overall, there was one non-driver for every 2.25 drivers. We compared this with a major utility's regional transport organization that had duties and vehicles comparable with those of bases, and found that the utility company required only one non-driver for every 5.4 drivers. The number of supervisors and overhead staff assigned to bases therefore appears to be high.

34.77 The high overhead-to-driver ratios can be attributed, in part, to the Department's method of calculating the number of supervisors and administrative staff required. The Department generally uses the number of vehicles held by each base to determine the overhead requirement. However, compared with vehicle fleet owners studied, National Defence underutilizes its vehicles by 16 to 65 percent. Excess vehicles attract excess personnel.

Drivers at the best-performing bases drove over five times farther than those at the lowest-performing bases.

34.78 National Defence should install productivity measurement in all base transportation sections. It should set a date by which measures will be in place and set goals for raising the productivity of below-average units.

Department's response: The Department acknowledges the requirement to improve transportation productivity and utilization rates. The Department will incorporate improved methods of data collection and refine the data types to permit the measurement of base/wing performance. Automated systems are being updated to

collect data and permit benchmarking and productivity goal setting.

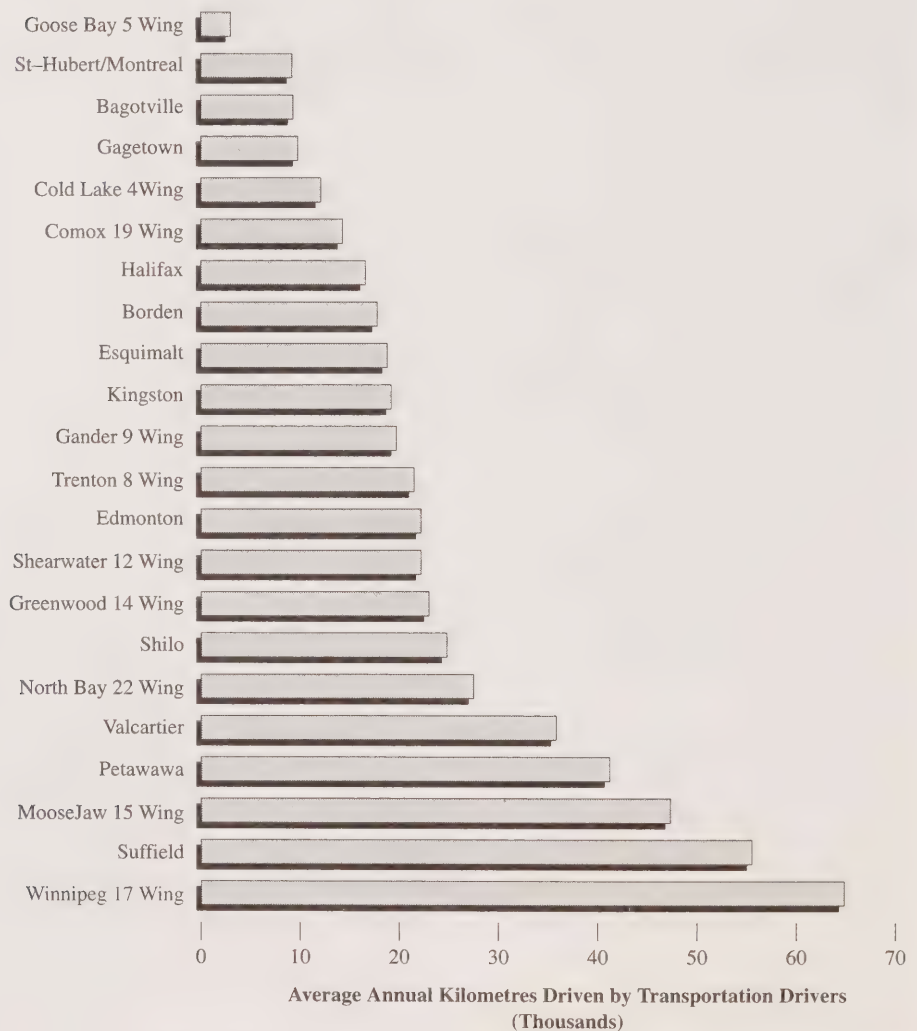
34.79 The Department should monitor the productivity of personnel in base transportation operations and adjust the number of personnel according to needs.

Department's response: The Department acknowledges the requirement to improve driver productivity tracking. The Department will redefine the data types being collected in order to permit improved analysis of driver productivity. Automated systems are being updated to

Exhibit 34.4

Kilometres Driven by Base

There are great differences in transportation productivity from base to base.



collect data and permit benchmarking and productivity goal setting.

Vehicle maintenance productivity is below industry averages

34.80 National Defence owns 9,225 commercial-pattern cars and trucks. We examined the productivity of this fleet.

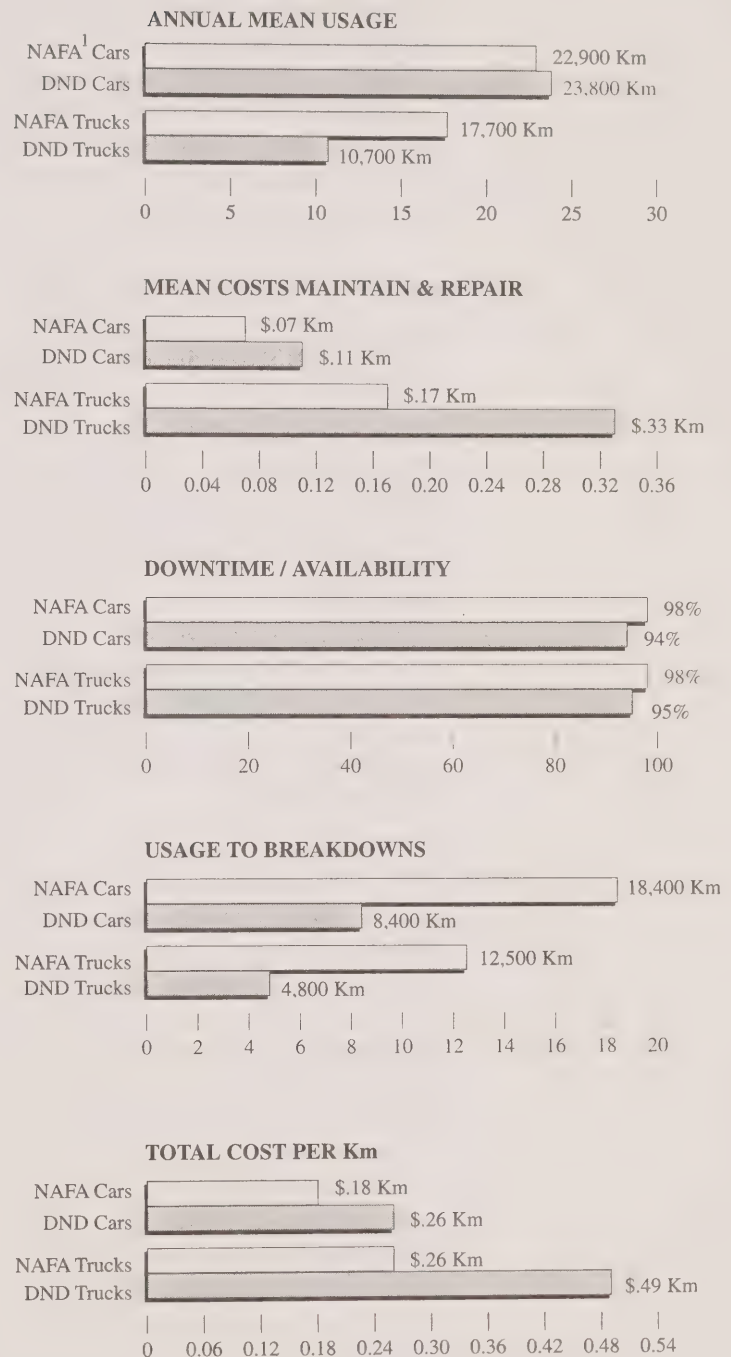
34.81 We compared data on the Department's performance with United States statistics compiled by the National Association of Fleet Administrators (NAFA) that were based on a survey of 91 public service fleets for the year 1992. We found sufficient data to compare the Department's performance for 5 of 11 NAFA vehicle indicators and one of two fleet performance indicators. National Defence was below the NAFA level of productivity on 4 of the 5 indicators (Exhibit 34.5). Officials told us they intend to further increase vehicle maintenance productivity through re-engineering. While the need to maintain military capability may limit the Department's ability to meet commercial standards, officials could not tell us how much of the difference this accounted for. Additional capacity maintained to meet military needs must be determined before options under its Alternative Service Delivery initiative can be evaluated. The Department intends to determine minimum military essential requirements through its Military Occupational Structure Review, now under way. This study should assist managers to determine which Alternative Service Delivery and re-engineering options to select.

34.82 We note that the Department could reduce its requirement for vehicle maintenance if it could dispose of its vehicles more quickly and reduce the age of its fleet. The average age of the NAFA car fleet is under three years, whereas the Department's average is six years; the

Exhibit 34.5

DND and U.S. Public Sector Vehicle Maintenance

Vehicle maintenance productivity is below that of the U.S. public sector.



¹ National Association of Fleet Administrators

NAFA truck fleet averages about four years old while the Department's average is eight years. Not only would newer vehicles require less maintenance, but fewer of them would be required because they would not break down as often. We noted that local managers have few incentives to dispose of vehicles that have reached the end of their economic lives. As a result, older vehicles that require more than average maintenance are kept in service, increasing maintenance costs.

34.83 A departmental study found that disposing of vehicles through the private sector instead of using the services of the Crown Assets Disposal Corporation (the current legislated practice) could provide significantly increased revenues from disposal. Treasury Board has authorized a disposal pilot project at four bases, allowing the Department full flexibility to choose the most cost-effective method of disposing of its surplus assets. The Department estimates that reducing fleet age, speeding the disposal process and using the services of a private sector disposal agency could save over \$3 million each year.

34.84 Vehicle maintenance costs could also be reduced if the Department made greater use of warranties. No command uses warranties for more than 10 percent of the work done on eligible vehicles, whereas commercial fleets file claims under warranties for between 50 and 75 percent of the maintenance work done on vehicles during the first three years of ownership. Although maintenance managers must consider factors such as lost driver time, distance to warranty repair facilities and the need to maintain military skills, officials agreed that increased warranty use represents an opportunity worthy of further study and action.

34.85 National Defence should review and manage the impact of the age of its vehicle fleet on overall vehicle maintenance productivity and make whatever changes are necessary to increase productivity.

Department's response: The Department has already taken steps to enhance overall vehicle maintenance productivity. The introduction of Plan Expert and Performa, which are maintenance management software applications, starting in fall 1996 will put significantly improved management tools in the hands of maintenance managers at bases across the Department. These tools will allow managers to measure the effectiveness of maintenance facilities and to gauge how well equipment fleets measure up to performance criteria. Managers will be able to better react to cost and serviceability trends and to take corrective action. These management tools will also give managers the ability to make trade-off decisions (based, in part, on vehicle age) as to the right point at which to buy new vehicles or to repair the existing fleet. In addition, the Department is engaged in extensive re-engineering of its maintenance, acquisition and disposal processes as well as improvements to management information systems and training, which will lead to even greater improvement in productivity.

34.86 The Department should assess the results of the disposal pilot projects and conduct such negotiations with Treasury Board as are necessary to reach the most cost-effective solution, including determining what incentives should be built into the overall system.

Department's response: Certainly the disposal process should be re-engineered as planned by the MCCRT. Negotiations with Treasury Board for a cost-effective solution will be pursued.

34.87 The Department should maximize its use of the vehicle warranties it has purchased.

Department's response: The Department is striving to maximize its use of vehicle warranties in order to minimize maintenance costs. With the devolution of funds to bases, newly re-engineered maintenance processes, and improved cost visibility and maintenance management information, managers will be truly accountable for the effective use of resources. This will include decisions to exercise warranties. It may well prove cost-effective at times to perform repairs in-house due to such factors as distance to dealers and the associated personnel costs of obtaining warranty services. Such decisions, however, will be taken in the context of overall maintenance cost effectiveness.

Other Management Functions

Air maintenance productivity is improving

34.88 The Department spent \$1.1 billion on air maintenance in 1993–94. Air maintenance is one of the most expensive functions in the Department, costing \$1.1 billion in direct costs each year, including contract costs. The Department has contracted out much of its air maintenance. Our audit focussed solely on the maintenance services provided from directly within National Defence. The CF-18 Hornet fighter consumes 32 percent of maintenance resources, followed by the C-130 Hercules at 13 percent and the Sea King naval helicopter at 9 percent. We addressed only the maintenance units on the bases. We did not assess off-base overhead and management operations.

34.89 Air Command monitors and integrates management renewal efforts. Air Command has set out a plan to

integrate and monitor change initiatives. Flight Plan 97 embraces all Air Command re-engineering projects and organizational activities. The plan covers projects designed to change the thinking in Air Command as well as the management tools necessary to support change. Air Command has begun three-day cultural training courses for all personnel. A group of dedicated staff at Air Command Headquarters collects in a database information on re-engineering projects to monitor their progress and to help communicate lessons learned throughout the Command. The database shows achieved and projected savings of some \$600 million.

34.90 Management support tools are being developed to establish task/resource contracts among Command levels; link resource consumption to both activities and tasks such as Maritime Sovereignty Patrols or Search and Rescue; and provide performance measurement feedback. The tools are interrelated and are designed to support moving the authority and accountability for resource management as close to the front line as possible. They will also provide a consistent view of costs to support business-case decision making and user-pay concepts. Management tools are being tested in trial projects and most are scheduled to be implemented by the fall of 1996.

34.91 Air Command has achieved impressive results through restructuring and re-engineering. We found that Air Command has already achieved significant savings in air maintenance. The establishment of the Air Force Command and Control Re-engineering Team has led to a reduction of 50 percent in headquarters staff. The process of defining roles has resulted in the identification and elimination of duplication among levels. Integrated

equipment management teams at headquarters manage aircraft supply, finance and engineering functions for each fleet.

34.92 In addition, much work has been done on the flight line itself. For example, the number of aircraft technician trades has been reduced from 12 to three. Cross-training required to implement the new trade structure for the most costly fleet to maintain — the fighter fleet — will be completed by the spring of 1997. Other

fleets will complete cross-training over the next three years. Through re-engineering, Air Command has reduced the maintenance costs of the DASH-8 aircraft from \$2,900 to \$1,300 per hour of flight, or by 55 percent. Developments at Cold Lake Air Maintenance Squadron have been particularly impressive, resulting in a 31 percent reduction in staff (Exhibit 34.6).

Exhibit 34.6

CFB Cold Lake Air Maintenance Case Study

The Cold Lake Air Maintenance Squadron is an example of improved productivity.

In 1994–95 the Air Maintenance Squadron at Cold Lake, Alberta, which services the CF–18 Fighter aircraft, began a renewal process. Faced by the threat of privatization of many of its services, management carried out a series of steps to redefine the maintenance process.

Re-engineering centered on best practices. The Squadron followed well-known re-engineering techniques. Teams made up of maintenance technicians, customers and others from outside the military challenged current practices. Together with management they drew up action plans for change. The organization was flattened. There are now only three levels between the shop floor and the Commander. Processes were changed to require fewer approvals. Wherever possible, one person completed the work and a second approved it. Procedures were developed to speed up the movement of parts and reduce paperwork. Cross-training was provided to allow for more flexibility in work flows. Budget control devolved to the responsibility centre managers, thereby providing an incentive to spend less. Responsibility centre managers were authorized to spend unused budget on small pieces of equipment to improve the work.

Results are impressive. Not only did the Squadron reduce staff by more than 30 percent, but staff took on new initiatives that will result in further savings. For example, suggestions were made to test parts before sending them to contractors for repair. This nearly eliminated parts returned “no fault found”. In another case, maintenance staff decided to see if they could fix a gauge that was regularly sent to a contractor for repair. They found they could repair the gauge for half the cost the contractor charged. While the part may still be sent to the contractor for repair, there will be a considerable saving on the contract cost. Prior to the re-engineering, staff were not permitted to try “experiments” like these. Now they are actively encouraged to try new ideas. A renewed focus on mission capability is evident in the work. Staff are developing ideas on how to make their test equipment portable. Despite the decrease in numbers, staff morale in the shops is very good. Staff have a renewed sense of pride and ownership in their work and, more important, they believe that management has come to trust and value their ideas and efforts.

Improvement is continuing. The Squadron has decided to implement the ISO 9002 quality process in place of its old, confrontational quality management system. ISO places the emphasis on building-in quality. The Squadron hopes to use ISO to promote continuous improvement and to emphasize customer satisfaction and cost effectiveness. The system will also help to implement delegation of authority by documenting the qualifications required to perform each process. These will be compared with lists of the qualifications of each staff member maintained in the quality manuals. ISO is also expected to eliminate a third of the currently required signatures. Annual audits by an independent organization help to ensure continuous attention to quality. This is particularly important in an environment where the senior officer changes every two or three years. The pre-certification audit has already identified potentially serious concerns that were previously not recognized. In addition, ISO will require one manager in place of five quality management staff. In another area, the Squadron has also identified the need to re-engineer the data control process.

34.93 The 1996–2001 Business Plan for Air Command sets out future initiatives designed to produce further savings through reduced operations, automation, consolidation and re-engineering of processes.

34.94 Air Command needs to build on its success. While some maintenance operations have been re-engineered, other units have not yet achieved savings. Officials told us that the delay was due to the need to wait for the completion of other re-engineering projects affecting maintenance personnel. Comparisons of units show wide discrepancies in the effects of re-engineering efforts on downsizing and in the time required to perform similar tasks. Staff believe that the more advanced bases are one to two years ahead of other units. Downsizing and an evaluation of activities have prompted some restructuring rather than a re-engineering of the processes. A 1995 study indicates that streamlining

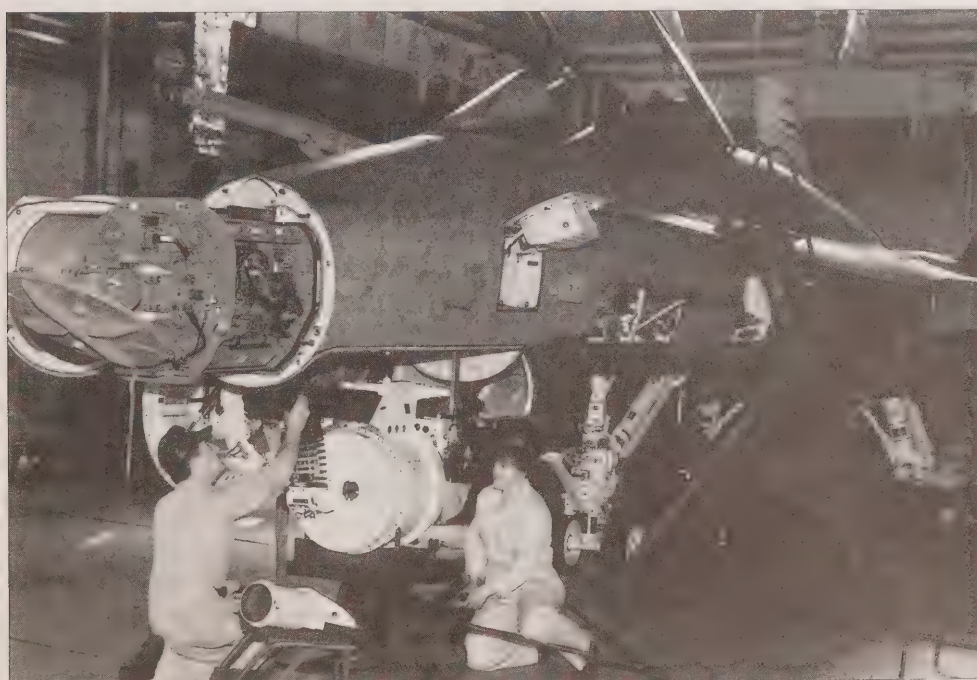
maintenance operations could save \$180 million each year.

34.95 Bureaucracy is the problem.

The central problem creating low productivity in air maintenance is the way it is organized and controlled. We found, for example:

- There are too many people involved in approval of work. Change orders and other authorizations can require up to 32 different signatures.
- There is insufficient delegation of decision making to the air maintenance units. In the commercial sector, Transport Canada uses the concept of regulation by objective, establishing regulations and standards for conduct. Air carriers have the flexibility to establish the most effective processes to meet their needs while conforming to those regulations and standards. At National Defence, the central authority at National Defence Headquarters decides both the “regulations” and the “process”. The private sector “bottom line” provides the incentive to work with Transport Canada

While the initiatives under way show promise, it will take continued management effort to ensure that they are implemented throughout Air Command and deliver the expected benefits.



Impressive productivity gains have been made in CF-18 maintenance at Cold Lake (see paragraph 34.92).

Air Command could do more to integrate operational units. The private sector has found it invaluable, in streamlining operations, to co-locate engineering, finance and supply services with the maintenance organizations they support.

Air Command needs to focus on the development of key systems to improve the performance of air maintenance.

during the development of requirements. At National Defence there is a disconnect between those responsible for producing policies and those responsible for managing the resources affected by them. As a result, policies tend to be overly conservative. The policies have acted as a disincentive to air maintenance units looking for better methods of maintenance.

34.96 The financial accountability for air maintenance is not clearly defined. No one has an incentive to minimize the use of resources and cost of materiel and, consequently, the wing (base) or squadron levels have not considered the cost of resources in their management of aircraft.

34.97 Cost information and other management support tools are lacking. A second problem is that cost information is lacking. One of the primary requirements to manage the cost of support is access to adequate costing data. This enables well-informed priority/cost benefit judgments to be made prior to the approval of actions. We found that, because computer-based systems are inadequate, maintenance staff calculate by hand the cost of maintaining the DASH-8 and the cost figures in the business plan. We also found that tools like Cost Centre Management are not yet accurate. Costing models contained in the system were constructed prior to downsizing and reorganization. As the organization changes, the tool becomes increasingly inaccurate.

34.98 Although the use of benchmarks is common in industry, the Department has yet to complete the development of the performance indicators proposed in the business plan. Air maintenance units have not yet begun to develop computerized maintenance systems to optimize maintenance tasks and aircraft scheduling.

34.99 Air Command should apply the lessons learned at Cold Lake at all bases possible.

Department's response: In response to the 1994 White Paper on Defence, Air Command created Project Genesis with the mandate of reducing the cost of the fighter force by 25 percent. This project is a joint Materiel Group and Air Command initiative with a scope of flight line to contractor. As a consequence, Cold Lake, a fighter base, was in the vanguard of the effectiveness and efficiency initiatives that now permeate Air Command. Since that time, Maritime Genesis, Transport Genesis, Tactical Helicopter Genesis and Air Training Genesis have begun to address the wings (bases), organizations and fleets in those communities. To ensure that the lessons learned at Cold Lake and other wings are applied across Air Command, a Genesis Initiatives database has been created. Further, Air Command is about to start a Doctrinal Wing project to ensure sufficient standardization across wings to allow integrated air power projection and to incorporate successful initiatives into Air Command Wing doctrine.

34.100 Air Command should provide unit managers with reliable cost information at the earliest possible date in order to improve decision making and accountability.

Department's response: Air Command is currently in the process of instituting Activity Based Costing (ABC) at its wings. A successful proof of the concept has been conducted at 416 Squadron and selection of software tools is complete. The target for implementation at all wings is December 1997. The use of ABC tools at wing level will give cost visibility relative to activities and will provide an options analysis ("what if") capability. Providing this information to wing-level managers is a significant step in improving managers' decision making and accountability.

The training system's productivity has declined

34.101 The training system is large and costly. The Canadian Forces provide individual training to allow personnel to gain knowledge and skills. Much of this training is in technical trades similar to those in civilian industry, taught in community colleges. Other training relates to specific military skills. At the time of our audit, the Department had 54 schools employing more than 5,770 people and producing 1.6 million training days. The overall annual standard cost of delivering this individual training is more than \$687 million.

34.102 There have been long-standing productivity problems. In 1990 we reported that National Defence was not competitive with the community college system in the provision of technical training. In one case, we noted that departmental costs were almost four times higher than those of external providers. We recommended that the Department compare its costs with those of civilian colleges and either use the information to reduce its costs or contract out. The Department promised to compare costs to ensure that it selected the most efficient and effective means of training. However, we found no productivity measurement in place during the course of the present audit.

34.103 Training in 1994–95 was 40 percent less productive than in 1990–91. Our audit examined a period during which the government rapidly reduced the size of the Canadian Forces. Support services were required to adjust to this change. Our audit included all 47 schools that have been in existence since 1990 and that have no operational support role other than training. They deliver 75 percent of the Department's

individual training, employ 5,067 people and cost over \$550 million a year to operate. We carried out our audit by looking at trend data, comparing similar schools with each other, and comparing departmental schools with United States military training centres.

34.104 We found that in most of the Department's schools, productivity has declined since 1990. Overall, each staff member in 1995 produced 61 percent of the training days produced in 1990. While some schools had improved by as much as 300 percent, others had declined to one fifth of their 1990 productivity (Exhibit 34.7). Schools providing similar training sometimes vary widely in their productivity. For example:

- at the two language schools, student/instructor ratios ranged from 3.2 to 9.1 students per instructor; and

In 1990, training productivity was low. As the Canadian Forces have downsized, productivity has declined dramatically.



Training is less productive than in 1990 (see paragraph 34.104).

- general trades schools (excluding language schools) ranged from 2 to 4.3 students per instructor.

34.105 Productivity has declined more rapidly than in United States

government schools. We compared Canadian Forces schools with United States government schools for which the U.S. Bureau of Labor Statistics tracks productivity. Although the two populations are not exactly the same, 40 percent of the U.S. schools were military and others offered similar training. Compared with them, productivity in Canadian Forces schools has lagged. In both countries, due to government cutbacks, the number of students has declined. The American government schools have almost kept pace with their downsizing, productivity having declined only 12 percent. The Canadian Forces schools have suffered a productivity decline of almost 40 percent during the same period (Exhibit 34.8).

34.106 The Department has not taken productivity into account in allocating personnel to schools. It does not have performance measures that allow it to adjust labour requirements depending on the level of output it seeks. Differences among similar schools indicate that cuts might have been imposed in an arbitrary fashion.

34.107 Other aspects of training management have improved. In 1990, we found that about 62 percent of individual training delivered by the Canadian Forces Training System either was not required by graduates on the job or had been learned before they received the training. We recommended that the Department increase its efforts to validate training. During the present audit we found that since 1993 the Canadian Forces Recruiting, Education and Training system has validated 40 percent of its qualifications. We did not examine the

Exhibit 34.7

Canadian Forces School Productivity

Training productivity has declined since 1990.

School Productivity Level Compared with 1990	Number of Schools	Number of Personnel in 1994-95
20% as productive	2	262
21-30% as productive	2	198
31-40% as productive	3	539
41-50% as productive	6	414
51-60% as productive	5	862
61-70% as productive	5	412
71-80% as productive	8	1,212
81-90% as productive	3	331
91-100% as productive	3	94
101-110% as productive	3	236
111-120% as productive	2	195
121-130% as productive	2	131
137% as productive	1	37
164% as productive	1	63
296% as productive	1	7
ALL	47	4,993*

* Total does not include Combat Training Centre personnel who are included in the 5,067 figure mentioned in paragraph 34.103.

adequacy of the validation of the individual courses in each qualification.

34.108 National Defence should assess its need for any instructors and support staff above the 1990 level per student as soon as possible and adjust staff levels on a continuing basis thereafter to meet actual needs.

Department's response: During the audit period, a steady-state forecast of student loads could not be identified due to significant and unprecedented changes to requirements caused by the rapid downsizing of the Canadian Forces. Without the target requirements clearly identified, it was impossible to change training infrastructure appropriately. As reiterated and acknowledged in all previous Auditor General reports, the Canadian Forces trains its personnel to meet validated operational requirements.

Adjustments to instructor and support staff establishment positions are constantly being made to reflect decisions on Force structure, departmental re-engineering initiatives and changes to qualification standards. The lag in adjusting staff levels in the 1991–95 timeframe is now being

made up and some of the schools studied in this report, particularly the Canadian Forces Recruiting, Education and Training System, employ far fewer staff than they did in 1994–95. Additional cuts have been determined for 1995–96 and 1996–97.

Reporting to Parliament

34.109 The Department devotes several pages in its Part III of the Estimates and in its May 1996 *Outlook* document to its renewal efforts. The Department has increased the amount of performance information it provides. The *Outlook* document reports on the status of almost 140 specific items, including several items regarding renewal, but these are often difficult to interpret. For example, the Department states that it has a goal to “improve resource management through Defence 2000 (and subsequently through the Management, Command and Control Re-engineering initiative)” and reports that this is “ongoing. Restructuring and Alternative Service Delivery initiatives [are] in place.” The additional detail represents progress, but much remains to

**Productivity Measured against 1990-91 Baseline
(Percentage)**

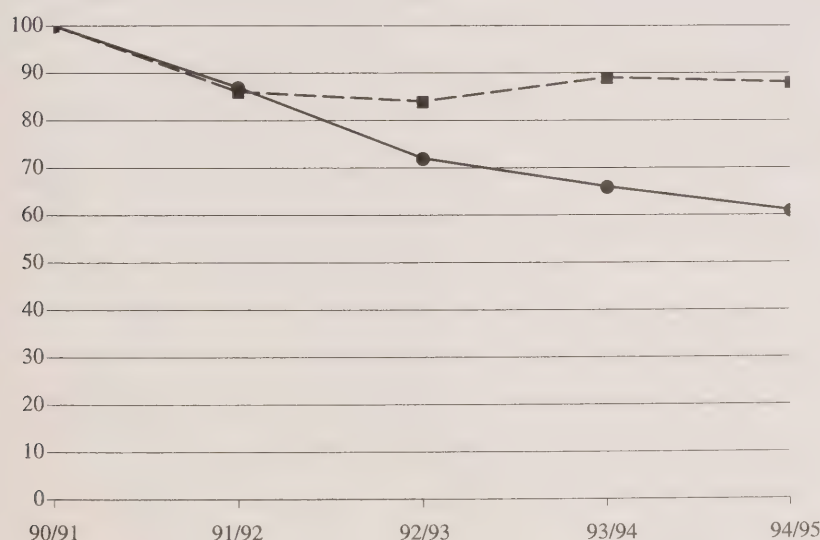


Exhibit 34.8

Productivity Trends of Canadian Forces and U.S. Government Schools

DND's school productivity has declined at a much faster pace than that of U.S. government schools.

U.S. Government Schools —■—
DND —●—

be done. Treasury Board ministers have recently asked that the Department provide a full range of results-oriented performance indicators in its next Business Plan to facilitate results-based evaluation of departmental programs, operations and projects.

34.110 This audit shows that, even with existing data on costs and performance, much more can be done to allow Parliament to assess whether the Department's turnaround effort is succeeding.

34.111 National Defence should develop meaningful measures of its support activities and should include the most significant ones in its reporting to Parliament.

Department's response: Difficulty in developing meaningful and useful performance indicators is being experienced across the public sector; it is not confined to DND. The Department recognizes the importance of performance indicators and is developing them as an integral component of the business planning process and in keeping with the Improved Reporting to Parliament Project, which is sponsored by the Treasury Board Secretariat. This is an iterative process that, in the end, will generate indicators that are meaningful and useful.

The Department needs to put greater emphasis on cultural change and on the measurement of service productivity.

Conclusion

A Mid-Course Correction Is Required

34.112 The Department of National Defence has begun its management renewal process, but has of necessity been forced to concentrate on implementing personnel and budget cuts mandated in the 1995 and 1996 Budgets. Major re-engineering initiatives such as

Operation Excelerate and Operation Renaissance appear to be on track but are only now entering the implementation stage, and are consequently difficult to assess. The older Base DelegAAT program has achieved the gains claimed for it by the Department.

34.113 Our audit indicates that management needs to reassess the approach taken to renewal by some units. Business planning and operating budgets are only slowly coming into effect and will likely take additional time to affect management behaviour. Although some bases have made considerable progress in improving local productivity in certain functional areas, these best practices have not been put in place in other units.

34.114 Senior management has identified the need to change values and beliefs from a focus on bureaucratic rule-following to one of independent initiative and cost consciousness. The Department has made commendable efforts but needs to do more in this area. The employee surveys that have been done indicate a great gap between the current culture and the one required if the Department is to benefit from business planning and the use of operating budgets. Addressing this challenge is a vital necessity.

34.115 Where productivity can be compared with that of service providers outside the Department, it tends to be low. It appears that budget cuts and downsizing have reduced the need for support services faster than the Department has reduced these functions. Management lacks the information to detect these drops in productivity, is often constrained in its ability to act, lacks incentives and has been preoccupied with implementing budget reductions.

34.116 The Department has built its renewal strategy around freeing up middle

management and encouraging initiatives that would improve productivity. Its business planning initiative and operating budgets were meant to provide the basis for doing this. After two years, it is evident that while these steps are necessary, they alone have not been sufficient. Managers still lack cost and performance data with which to make business cases for change. Current values and beliefs conflict with the expectation that “bottom-up” change will occur.

34.117 The Department has become smaller, but its support services have not yet become more productive. Until they do, the Department has no assurance that it can produce the combat capability called for in the 1994 White Paper with the reduced resources available. Until measurement of outputs is in place, it is not possible to say for sure that defence capability is not declining faster than the defence budget is falling.

34.118 The Department needs to place greater emphasis on measuring costs and outputs and on ensuring that tools to do so are in place. It also needs to increase its efforts to ensure that its culture will match the management approach it says it wants to put in place.

Consequences Could Affect Military Capability

34.119 The Minister has said in his *Outlook* document that budget reductions are not expected to affect the roles and capabilities of the Canadian Forces as described in the 1994 Defence White Paper. The *Outlook* document says that these cuts amount to a 30 percent reduction in the Department’s purchasing power. The only way defence capability can remain the same while resources diminish is for productivity to increase. Our audit indicates that this is not yet occurring. The consequence could be that while the Canadian Forces continue to maintain the same number of combat units, they will be less well-trained and equipped. Our May 1996 chapter on Peacekeeping (Chapter 7) indicates that training and equipment are already suffering from lack of resources. The Minister’s *Outlook* says that by 1998–99 the capital portion of the budget — needed to modernize the Canadian Forces — will decline from 24 percent of the defence budget to 20 percent. Given the Department’s requirement for modernization, this is a troublesome trend.

34.120 Our audit indicates that the Department has the capacity to move additional resources from overhead and support to capital and training — from “tail” to “teeth.” To do so, the Department should consider the measures recommended in this chapter.



About the Audit

Objectives

The objectives of our audit were to:

- compare the productivity of defence support functions within the Department and with other external providers of similar services; and
- report to Parliament the effects of National Defence's renewal efforts begun in response to budget reductions and to commitments made to the Public Accounts Committee in 1994.

Scope

Our audit focussed on two management levels: the corporate level, which manages programs and functions that are national in scope; and the base or unit level, which manages a single location where work is performed.

We reviewed the Department's major initiatives at the corporate level, including major re-engineering and change projects; the Department's business planning reforms; its operating budget initiative; and its management of cultural change. We also looked at three specific change and re-engineering projects managed at the corporate level: the Red Tape Action Team, Military Pay Services and Food Services.

Of 29 existing bases, our audit includes 22 bases the Department intends to keep operating. Bases slated for closure were excluded to avoid biasing the results of the audit. We concentrated on the supply, transportation and vehicle maintenance functions. The bases we included account for 82 percent of base personnel in the Department and the functions we examined account for 35 percent of the personnel on those bases.

We also examined air maintenance and individual training, which are two major support functions not administered through the base organizations. Air maintenance employs 3,900 people, and schools that deliver individual training employ 5,770.

Criteria

In assessing the Department we used goals and standards established by the Department itself, trends over time, and comparisons with others performing similar work in both the public and private sectors. Detailed criteria are discussed in each section along with audit findings.

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Chapter 35

**National Defence — Follow-up
of the Auditor General's
1994 Report**

The follow-up work was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants.

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National Defence — Follow-up of the Auditor General's 1994 Report

Assistant Auditor General: David Rattray
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Main Points

35.1 In 1994 we reported on Defence management systems, information technology, infrastructure reductions and infrastructure management. This chapter reports on the progress made by National Defence in addressing our recommendations and those of a subsequent report by the Public Accounts Committee.

35.2 The Department did not put an adequate system in place to ensure that its management responses to our 1994 recommendations were implemented. Because departmental commitments were not adequately monitored, some action plans were not fully implemented.

35.3 Progress has been made in implementing our recommendations on the Defence management systems required to plan, organize, direct and control the defence of Canada, but more remains to be done. For example, the Department has begun to assess and report on the affordability of defence policy, but its assessment is limited to a five-year time frame.

35.4 The Department has made significant progress in implementing our recommendations on information technology. Cost reduction has been a major focus within the Department over the last two years. The Department supports the management approach to information technology projects recommended in our 1994 Report as well as by the Treasury Board Secretariat. However, the completion date of the Strategic Message Switching System (SMSS), which would generate net savings of \$52 million a year, has slipped about 24 months and the Land Force command and control system will not be fully interoperable with the rest of the Department before 2001.

35.5 Significant progress has been made to rationalize infrastructure. The Department appears to be on schedule in implementing its reduction plan. In addition, the process for determining new and replacement infrastructure requirements should improve the timeliness and cost effectiveness of construction projects. Progress has been slow in developing maintenance strategies.

35.6 Progress has been made in implementing our recommendations on infrastructure management. Construction projects are now managed using a revamped organizational structure and attempts are being made to incorporate innovative practices. The full success of this new construction delivery system depends on the successful implementation of business planning at the command and base levels. Almost all of the bases are considering alternative service delivery for their construction engineering functions. However, more remains to be done to eliminate the 10-year maintenance backlog, end operating shortfalls on married quarters, and reach agreement with municipalities on the level of service to be provided for grants in lieu of taxes.

Introduction

35.7 The Auditor General's 1994 Report included four chapters on the Department of National Defence. Chapter 24 dealt with Defence Management Systems, Chapter 25 addressed Information Technology, and Chapters 26 and 27 reported on Infrastructure Reductions and Infrastructure Management respectively. This chapter reports on the progress made by National Defence in addressing our recommendations.

35.8 The House of Commons Standing Committee on Public Accounts reviewed the National Defence chapters of the 1994 Report of the Auditor General and made 29 recommendations to the government in its Twelfth Report, dated 12 June 1995. We have also followed up on those recommendations.

Departmental Response to Recommendations

Background

35.9 The Deputy Minister and the Chief of the Defence Staff provided a management response to our 1994 chapters in which they agreed with most of the recommendations and stated they would take corrective actions. According to departmental officials, once the 1994 Report was tabled in the House of Commons, copies of the document were distributed to group principals within National Defence Headquarters and environmental commands: Maritime Command, Land Force Command and Air Command. The Department assumed that the Report would be circulated to subordinate levels through the chain of command and that action would be taken at appropriate levels. Because

departmental commitments were not adequately monitored centrally, some action plans were not fully implemented.

Conclusion

35.10 Improvements made by the Department appear to be more the result of the efforts of individual managers than of an overall plan to implement the Department's response to our Report. Nevertheless, significant progress has been made on three of the four chapters, specifically Infrastructure Reductions, Infrastructure Management and Information Technology.

Observations

35.11 Copies of the 1994 Report were not formally transmitted to group principals and the environmental commands. Two years after tabling of the Report in the House of Commons, neither Air Command nor about half of the group principals had a copy of the Report. The two other commands obtained a copy on their own initiative.

35.12 Most of the staff officers concerned within National Defence Headquarters groups had received a copy of the Report, but some could not identify the source. No action was required by senior management to implement recommendations, and no direction or instructions were provided to subordinate levels to take action on the recommendations. Staff officers from Maritime Command and Land Force Command have still not received a copy of a recommendation addressed to the commands. Some staff are uncertain about whether they are required to take action on audit recommendations. One command official told us that he would feel uncomfortable taking action without any direction.

The Department did not put an adequate system in place to ensure the implementation of its management responses.

35.13 An example of this lack of direction can be found in the implementation of the recommendation that the Department do everything possible to complete readiness measurements, operational exercise programs and post-exercise reports. Command readiness reporting systems and collective training are command responsibilities. However, National Defence Headquarters did not provide direction to command headquarters to take action even though the departmental response was "Agree". As a result, no significant progress on this item has been made since 1994.

35.14 The Department is in the process of developing an integrated mechanism for implementing and monitoring the

recommendations of the Office of the Auditor General and the Public Accounts Committee. Once final responses have been formulated and released on behalf of the Department, the Vice-Chief of the Defence Staff will issue directions for formulating implementation plans within the Department. When approved, detailed departmental action plans will be developed for key recommendations and these plans will be monitored through their completion, by the Chief Review Services on behalf of the Deputy Minister and the Chief of the Defence Staff. Intranet technology, scheduled for introduction late in 1996, will likely provide a focal point for sharing the status of implementation plans across the Department.

Defence Management Systems — 1994, Chapter 24

Background

35.15 The Department of National Defence and the Canadian Forces require management systems to plan, organize, direct and control the defence of Canada. Chapter 24 of our 1994 Report was aimed at ensuring that the 1992 Canadian defence policy requirements were adequately translated into a force structure; that senior managers had appropriate information for decisions; and that collective training and readiness systems were properly implemented in order to monitor progress of defence policy goals. Our 1994 audit examined the basic building blocks of the Department's overall management system: the defence policy planning and force development system; cost management systems; the military readiness reporting systems; and the systems used to manage personnel, supplies and medical resources in emergencies and war.

Conclusion

35.16 The Department has made significant efforts to improve cost management systems and to install its business planning system, but these efforts have not yet borne fruit. We found that problems still exist in force development, readiness reporting systems, and cost and performance data.

Observations

Defence planning and force development processes

35.17 Defence planning and force development processes are used by the Department to translate government policy into military forces. In 1994 we recommended that the policy planning process include detailed information on

specific conflict scenarios, explicit links between policy and force structure, a full assessment of affordability, and readiness and sustainment goals. We also recommended that these elements be presented in public documents. The Department agreed with the general intent of the recommendation to provide greater detail in policy documents about the kinds of situations that the Canadian Forces must be able to deal with. It also stated that affordability would continue to be a major priority, and program or policy changes would be made if and when appropriate.

35.18 Conflict scenarios. In 1994 we recommended that the Department clarify the range of conditions under which the Canadian Forces are expected to operate, by using conflict scenarios. This would provide clearer information to Parliament and more adequate guidance to force development planners. The Department said it agreed with the "general intent" of our recommendation. At the time of our follow-up, the Department had developed operational and force structure plans around four key scenarios: the deployment of stand-by forces, the deployment of main contingency forces, the sustainment of main contingency forces and full mobilization. The 1994 White Paper provides additional detail on the potential employment of the Canadian Forces. Further improvement could be made to the scenarios by the addition of explicit threat descriptions, and consideration of force options and of costs.

Department's response: With respect to conflict scenarios, the suggestion that they could be improved by the addition of explicit threat descriptions and force options is accepted in principle; while these factors are considered by National Defence Headquarters planning staffs

The Department did not cost the 1994 Defence White Paper, and the departmental force structure developed from it may no longer be affordable.

today, an effort will be made to further enhance this aspect of contingency planning. In regard to the costing of hypothetical scenarios, the Department considers that this function is best dealt with as part of the process to prepare options for government consideration; with the introduction of activity-based costing, it will become relatively simple to accurately determine the costs associated with any particular force option.

35.19 Affordable force structure. In 1994 we found that the affordability of defence policy was problematic because the Department included the costs of only activities and projects it had approved and not all those necessary to implement the policy.

35.20 The Public Accounts Committee made two recommendations related to affordability studies. One recommendation asked the Department to do complete and detailed cost information and affordability studies on essential elements in all its defence planning and force development processes. The second recommendation asked the Department to include information on affordability in public documents, such as business plans and Part III of the Estimates. The Department agreed with both of those recommendations.

35.21 We found that although the capability requirements of the 1994 White Paper had never been costed, force planners had judgmentally assessed them against existing resources and anticipated funding. They had concluded that the policy requirements were affordable.

35.22 The current planning approach is to take steps to reduce the overall demand for resources and ensure overall program affordability. This means that planners start with a finite resource envelope and prioritize their requirements accordingly.

The detailed planning horizon has been reduced to 5 years from 15. The plan implies that, while capabilities judged essential to support the White Paper can be sustained for the next five years, no guarantees are offered after that date. The plan, however, is moved forward each year so that it always extends five years into the future. The approach is essentially budget-driven and rations available resources rather than estimating long-term needs. Senior officials told us that they managed long-term shortfalls by extending internal plans out to 15 years and by bringing shortfalls to the Minister's attention in a timely fashion.

35.23 With this approach, "affordable" does not necessarily mean sustainable indefinitely. Given the 30-year life span of equipment and the lengthy acquisition process, there appears to be a risk that gaps and shortfalls may result. The Department has completed analyses that indicate these may in fact occur. In May 1996, the Department prepared a development framework model based on activities and projects already approved for implementation in the 15-year fiscal planning framework and on the reference planning budget levels approved by the government. The model reflects overprogramming in capital, personnel, and operations and maintenance in 1997-98 and beyond, which will require adjustments to allocations. The Department believes the level of overprogramming to be acceptable and a useful management tool, given the size of its budget.

Department's response: *Regarding the affordable force structure comments, the Department contends that the force structure required to support the 1994 Defence White Paper remains affordable. However, as noted in the 1996 Outlook document, the Department also recognizes that, in the longer term, a higher level of*

capital spending may be required to prevent rust-out.

35.24 Public reporting. In keeping with its commitment to the Public Accounts Committee, the Department addresses affordability briefly in its 1996 *Outlook* document by stating that it considers its program affordable. It notes that post-1994 budget reductions will affect the Canadian Forces over the longer term and that “rust-out” and decreased performance may be unavoidable. It has not, however, provided the basis for its assessment or the magnitude of anticipated deficiencies. The Department also agreed to update departmental manuals to represent as accurately as possible actual policy-planning processes and capture innovations and departures from past practices. The Department has not yet revised its management manual.

Department's overall readiness reporting system

35.25 The Operational Readiness and Effectiveness Reporting System (ORES) was developed by the Department of National Defence to report to the Chief of the Defence Staff on the level of readiness of each command to achieve its missions and tasks, as described in the Defence Development Planning Guidance. Commands must provide quantitative information on levels attained in personnel strength, personnel training, equipment availability and materiel availability.

35.26 The Department has not submitted any ORES information to the Chief of the Defence Staff since the publication of our 1994 Report. Data are still being collected, but only significant new deficiencies are reported. The Department plans to integrate a new system with business plans in the 1997–98 fiscal year. Until then, the Department

will not have an objective and verifiable operational readiness reporting system for the Canadian Forces.

35.27 Officials pointed out to us that the new system they are developing will address the deficiencies raised in our 1994 audit:

- The system will be less subjective than the existing system.
- It will allow deficiencies to be traced to the units where they occur.
- There will be continuous tracking, rather than just exception reporting.
- Costs will be captured.

Officials told us that this system will be presented to senior management for approval in late 1996.

Command readiness reporting systems

35.28 Commands have also developed their own readiness reporting systems in order to manage their units. Our 1994 recommendation stated that the Department should do everything possible to complete readiness measurements. However, even though the Department agreed with the recommendation, no significant progress has been made in reporting readiness at command levels.

35.29 In 1994, we found that Maritime Command relied on three measurement and reporting systems: Combat Readiness Inspections, the Operational Readiness Requirements Reporting System and the Operational Deficiency Reporting System. Combat Readiness Inspections have not been conducted since 1994. Maritime Command officials explained that this system has been replaced by the assessment phase of the new Workups program. This program provides training to a team of a ship after a refit, a major conversion or a turnover of ship crews. We did not verify individual records of

The Department is still developing an objective and verifiable operational readiness reporting system for the Canadian Forces.

Slow progress has been made in reporting command readiness.

workups; however, officials assured us that workups were conducted in accordance with the program.

35.30 Maritime Command could not provide a report on progress made on the implementation of the Operational Readiness Requirements Reporting System required to assess readiness of operational teams on ships. No system has been developed by Maritime Command to ensure that readiness deficiencies identified in our 1994 chapter will be corrected. Due to the outdated nature of the required exercises, the Naval Reserve divisions have not conducted any assessments since March 1995.

35.31 In 1994, Land Force Command did not have a command system for evaluating and reporting on the readiness of units or formations. Since that time, Land Force Command has introduced collective battle task standards for the conduct of operations. These standards have been in force in draft format since September 1995 and were partly implemented for the VENOM STRIKE exercise. Fifty percent of their validation has been completed so far. Field Training Regulations, providing guidance for the conduct of collective training, were approved in principle by the Command in June 1996. Standards for operations other than war, such as domestic operations and peacekeeping operations, still have to be developed.

35.32 Air Command employs a testing system known as Operational Evaluation (OPEVAL) to assess the readiness of units. However, the Command has not developed any system to implement our 1994 recommendations. Following a major budget reduction in the spring of 1995, the Command began an important re-engineering of its activities. Operational evaluations continued but rethinking of the reporting system was

postponed to April 1996, pending the re-engineering of the whole Command. The new system is being redesigned in accordance with the new Command structure. At the time of our follow-up, Air Command did not know the extent to which units met the level of readiness required by the OPEVAL system. In response to our follow-up, Air Command updated the data reported in 1994 on OPEVALs, and in 1995-96, it assessed 5 of the 18 units subject to operational evaluations in accordance with the policy. An additional unit will be assessed after the prescribed period because of two successive deployments to Haiti in 1995 and 1996. No progress has been made since our 1994 Report when 7 out of 22 units were assessed, one of which was assessed after the prescribed time period.

35.33 Since our 1994 recommendations, progress has been made more in developing than in implementing command readiness reporting systems: Maritime Command is conducting workups but still does not know the extent to which operational teams on ships have achieved the required level of readiness; the Naval Reserve divisions do not conduct assessments anymore; the validation of the battle task standards developed by Land Force Command has not yet been completed; and Air Command has not developed any system to implement our recommendation. A departmental update of data reported in 1994 confirms the lack of progress made.

Collective training

35.34 At the time of our audit, environmental commands did not use the 1995 Defence Development Planning Guidance to develop collective training to achieve the 1994 White Paper commitments. A national training policy was approved for Land Force Command by the Army Council in April 1996 to

No progress has been made in reporting exercises conducted to achieve required readiness levels.

rectify the situation. Its implementation is planned for April 1998.

35.35 Even though the Department agreed with our recommendation to do everything possible to complete operational exercise programs and post-exercise reports, Land Force Command and Air Command were not able to provide information on progress made since 1994 in conducting planned major exercises and in completing post-exercise reports. Staff officers in the three commands were not made aware of the departmental response to our recommendation. To respond to our follow-up, Maritime Command reviewed major exercises conducted since our 1994 audit. All of the major exercises planned had been conducted by the Command: three exercises in 1994–95 and two in 1995–96. Four of the post-exercise reports had been produced thus far.

35.36 Officials told us that a new National Training Plan would be approved in the near future to link policy goals and defence development guidance to exercises. In addition, since the fall of 1995, the Department has been developing a national Lessons Learned Information System to capture and use exercise results.

Cost management

35.37 Departmental plans are translated into decisions through the senior management committee structure. Cost information is an essential element of management decision making. Decision makers need to know costs in order to compare various options. The 1994 chapter reported that managers lacked the necessary information and that there were few incentives to minimize costs. Cost-saving initiatives had been delayed by a lack of information. We recommended that the Department

improve information presented to senior management for decision making, possibly as part of its business planning initiative; develop cost information for decision makers on a timely basis, concentrating on critical areas first; review the accountability and incentive structure of cost information and make changes to promote improved cost management; and develop the capability to track the impact of major decisions, especially major cost reduction initiatives, to ensure that the intended results are being achieved. The Department agreed with those recommendations, referring to recent initiatives under way.

35.38 The Defence Support Productivity audit (Chapter 34 of this Report) examined departmental progress on “level one” business planning. Level one plans are developed by command commanders or group principals in National Defence Headquarters and approved by the Deputy Minister or the Chief of the Defence Staff. We examined whether those plans adequately described activities, objectives, priorities, performance measurements and expected results. Nearly all business plans described activities adequately, but some lacked a description of the intended results. Most plans lacked performance data and information on the cost of activities. As already noted, officials plan to correct this by 1997–98. We also found that the “data warehouse” required to act as a central repository for business planning had not yet received full funding approval. We noted some progress in developing business plans, but much of the effort has been expended on defining activities and objectives to provide a valuable base for further development. The Department has been very active in developing cost information systems but none of those initiatives has yet been completed.

Officials expect that a new National Training Plan and Lessons Learned Information System will help focus collective training.

35.39 The Department has defined business planning as an accountability process developed to link activities to performance measures through a contract between superiors and subordinate levels. Level one business plans were formally put in place on 1 April 1996. Even though local managers have been delegated more funds and are therefore accountable for more departmental resources, lower-level business plans have still not been implemented. The Defence Support Productivity audit confirmed the lack of performance information at all levels of the Department. We did not find any improvement or development of new incentive policies to promote cost management. The Department has, however, drafted a new financial signing authorities document that, when approved, will allow lower-level managers to exercise increased authority and to work more effectively within the framework of their business plans.

35.40 The Department has also implemented a tracking system for identifying cost savings arising out of the 1994 and 1995 federal Budgets. This system, called the Defence Expenditure Reductions Monitoring and Tracking report (DERMAT), tracks cost reductions coming from Cabinet-level decisions. The system provides biannual reports on the government's initiatives to reduce defence expenditures. However, the system does not track departmental initiatives to reduce costs that have not originated from government direction. For example, DERMAT tracks savings due to base closures but does not track the Department's Alternative Service Delivery initiatives. These initiatives seek to generate savings by replacing departmental service providers with non-departmental agencies or the private sector. DERMAT does not fully address our 1994 observation that dealt with the

lack of tracking for departmental management decisions.

35.41 The Public Accounts Committee recommended that the Department develop the means to provide managers with cost information relevant to the decisions they make. This information must be timely, accurate and verifiable. The Committee also requested that the Department report on progress made in providing its managers with the cost information they need. The Department agreed to these recommendations.

35.42 The departmental response to the Committee referred to initiatives that make cost information more readily available to managers: the Cost Centre Management Project, designed to identify and report costs by activity; the Customer Consumption Awareness Project, established to identify the cost of materiel consumed from inventories; and the Data Warehouse Project, established to ensure that the necessary hardware and software are in place to deliver the data. Our Defence Support Productivity audit found that cost information is lacking, although progress is being made. The Cost Centre Management Project continues to evolve in Air Command and the Department is improving data integrity. As previously noted, the Department has not yet funded the "data warehouse" intended to serve as a central repository for business planning data. Nevertheless, the Department is continuing to work on providing improved cost information to managers. A Managerial Accounting Working Group has been established and the Department intends to have an activity-based costing system in place by 1998.

35.43 The Committee recommended that the Department develop, on an urgent basis, the means to track the results of its cost reduction initiatives to ensure that the intended objectives are being achieved. In

addition, the Committee asked the Department to report on its efforts; however, as noted, the DERMAT report does not fully address the Public Accounts Committee's concerns about savings.

35.44 The Committee also asked that the Department continue to strengthen and improve its accountability and incentive structure. As part of this effort, the Department would charge to command and base budgets, to the fullest extent possible, the complete costs of resource consumption. We found that the Department has almost achieved the delegation of 40 percent of operating funds to commands and National Defence Headquarters groups. In addition, departmental officials told us they were pursuing a number of initiatives to improve the ability of managers to work more effectively within the framework of business plans.

The growth of major headquarters has stopped

35.45 In 1994 we reviewed the personnel levels of National Defence Headquarters and the environmental commands from 1983 to 1993. At that time we found that, while there was a general decline in the size of the Department overall, the number of staff working at major headquarters continued to grow until 1993. While 1993 staff levels had decreased, they were still only 4.3 percent below the 1990 figures despite claims by the Department that, since 1990, it had been in the process of reducing National Defence Headquarters by 20 percent.

35.46 Although we did not make any specific recommendations regarding this

observation, the Public Accounts Committee recommended that by 1999 the Department achieve its stated objective of reducing resources allocated to its headquarters by 50 percent, and that the Department submit annual progress reports on reduction of its headquarters staff.

35.47 The Department responded to the Committee that it will reduce by at least one-third the personnel and resources committed to headquarters functions, as stated in the 1994 Defence White Paper, and that it has adopted a "stretch goal" of 50 percent reductions for internal planning purposes. The Department also indicated that, commencing in 1996–97, it would include progress reports on its headquarters reductions in the departmental *Outlook* document.

35.48 In April 1995, the Vice-Chief of the Defence Staff reaffirmed the Department's commitment to obtaining a 50 percent reduction in headquarters resources by 1999. A commitment to staff reductions is also reaffirmed in other departmental documents such as the Information Management Long-Term Capital Plan and various Management, Command and Control Re-engineering Team documents. The initial figures supplied to the Public Accounts Committee in November 1995 suggested that staff levels in National Defence Headquarters had dropped by approximately nine percent from midyear 1994–95 to midyear 1995–96. Projections for 1999 indicate a total headquarters staff of as few as 7,100 military and civilian employees, suggesting a staff reduction to that point of almost 45 percent.

The Department is still confident of achieving its objective of a 50 percent resource reduction in headquarters by 1999.

Information Technology — 1994, Chapter 25

Background

35.49 The Department of National Defence is an organization composed of military and civilian personnel distributed among headquarters and operational units. Operations and activities are supported by complex networks of computers and telecommunications systems. Chapter 25 of the 1994 Report presented the findings related to three specific levels of management: program management, project management and operations management. The chapter also assessed progress made in developing military command and control information systems.

Conclusion

35.50 The Department has made progress in implementing our recommendations. Significant progress has been made in program management; however, improvement is still required to ensure that projects have a stable staff throughout the project life. Little progress has been made in fully developing and funding plans for telecommunications and computer operations. Interoperability of command and control communication systems needs further development for joint and combined operations.

Observations

35.51 Program management. Program management is the overall approach used by managers to make strategic choices and allocate resources within the Department for all information technology projects over \$3 million. The 1994 chapter found that the Department took too long to complete information technology projects, long-range budgets were not adequate and program management systems did not

sufficiently take cost reduction into account. The Department agreed with our recommendation to re-examine the way it managed its information technology program to ensure accountability, practicable long-term planning and assignment of priority.

35.52 The Public Accounts Committee recommended that the Department begin forecasting funds for future information technology projects on a five-year basis, and put in place a system that will give greater priority to projects that will reduce costs. The Committee also asked the Department to report on progress made in revising its Defence Program Management System as it relates to the management and acquisition of information technology.

35.53 We found that these recommendations are being carried out. The Defence Information Services Organization (DISO) is responsible for co-ordinating all information technology projects within the Department. DISO also produces an Information Management Long-Term Capital Plan focussing specifically on a five-year timeframe. Only 11 of the 54 information technology-related projects whose funding began on or before 1996-97 extend beyond 1999-2000. Cost reduction has been a major focus within the Department over the last two years. The Department is re-engineering its business processes in order to eliminate unnecessary work and reduce the labour associated with the remaining essential activities. It has also established a \$10 million investment fund targeted specifically at cost-saving projects, including information technology projects.

35.54 Project management. In 1994, problems also existed in project management or in the processes used to

The Department is implementing our recommendation on program management.

design and acquire individual systems. Definition of requirements and options analysis were inadequate and resulted in extra costs to the Department. We recommended that the Department use an evolutionary approach in developing information technology projects; that capital projects be approved after adequate options analyses had been completed; that directors and managers of information projects be adequately qualified; and that project staff be stable throughout the project's life. The Department agreed with our recommendations.

35.55 The Public Accounts Committee also recommended that the Department move quickly to adopt a modular approach to information projects by breaking them down into smaller, more manageable units. It also asked that the Department report to the Committee on the changes made in relation to information technology project management. The Department agreed with those recommendations.

35.56 As the result of a review that identified problems with the management of information technology projects in government, the Treasury Board Secretariat has published An Enhanced Framework for the Management of Information Technology Projects, which addresses many of the problems in project management previously identified in our 1994 chapter. In a letter to the Treasury Board Secretariat, the Department expressed support for the management of information technology projects in the manner noted in our 1994 recommendations as well as in the Enhanced Framework document. The Department identified several projects that are moving toward the implementation of our recommendations, in particular, the adoption of evolutionary acquisition,

whereby projects are divided into phases and subjected to independent review before receiving authority and funds to continue to the next phase. Because the Treasury Board grants approval for each step of an evolutionary project, the Department expressed concern that incremental approvals would result in an excessive administrative burden. Consequently, the Treasury Board and the Department have agreed to a process whereby Treasury Board ministers will approve projects and delegate release of funds for each step to the Secretary of the Treasury Board. This approach is intended to provide independent review of projects while minimizing the administrative burden.

35.57 The Department has now revised the Defence Program Management System to include consideration of such alternatives as "commercial-off-the-shelf" purchases, partnerships, joint ventures and leasing, with each project proposal. In developing the Information Management Long-Term Capital Plan, project business cases are included in the documentation associated with specific projects. The Department states that for some applications, a cost/benefit analysis that justifies the investment can often be shown; however, the financial benefits associated with common infrastructure and applications are more difficult to identify because the benefits are distributed throughout the organization's various functional domains. The Department also points out that while savings may be part of the business case, intangible factors such as doing the job more effectively will also be included.

35.58 On the issue of project management qualifications, the Department is developing guidelines to provide project management training, co-ordinate the implementation of projects

from a management and technical point of view, and oversee the progress of projects. The latter point especially will involve improved standardization of information technology project design and development procedures, including risk assessment, and continuous project performance assessment using normal good project management practices as well as progress assessment tools.

35.59 When asked what formal steps it had taken to ensure stable project management throughout the life of the project, the Department responded that while no formal policies or procedures had been adopted, the modularization of projects should lead to shorter projects. The shorter project life spans should lead in turn to a lower turnover of military management staff. In response to our recommendation, the Department has also stated that the assignment of qualified project managers and their availability for the life of the project must be consistent with the exigencies of the Canadian Forces and the availability of qualified civilian personnel.

35.60 Operations management.

Operations management is the in-service use of information technology throughout the Department. We found that operational efficiency and effectiveness were affected by the lack of adequate central management of the entire program. We recommended that users of information systems be suitably trained, that information systems contain the data required for users to perform their jobs, and that transferability of data between systems be improved. The Department agreed with our recommendations. We did not survey users of information systems in the follow-up.

35.61 We identified possible savings in telecommunications and computer

operations. Our 1994 chapter recommended that plans for the Strategic Message Switching System (SMSS) and the Defence Telephone System (DTS) projects be fully developed and funded. The plans should describe benefits, provide accurate estimates of capital and operating costs, provide a detailed implementation schedule and address technical and personnel impacts. We also recommended that costs be reduced by accelerating the rate at which users are added to the Integrated Data Network, and that adequate information be available to support business planning for management of telecommunications services. The Department concurred with our recommendations, subject to availability of security products.

35.62 According to a submission to the Treasury Board, implementation of the SMSS would generate net savings of \$52 million a year to the Department. However, the completion date of the project has slipped by about 24 months, which will delay the start of savings. The Defence Telephone System project has progressed but is less advanced than the SMSS. The DTS plans do not yet clearly state savings, costs or an implementation schedule. Officials told us that the evolution plan is undergoing change despite the fact that \$4.6 million was to be spent in 1996–97 and \$0.2 million in 1997–98 out of a total budget of \$7.25 million. Additional delays are expected.

35.63 Our recommendation on cost reduction relating to the rate at which users were added to the Integrated Data Network (IDN) is now obsolete. The Department is gradually replacing the technology used for IDN with the new Frame Relay and Asynchronous Transfer Mode communications protocol, which provides more capacity and connectivity.

35.64 The Department has not developed detailed information on the use of communications to support business plans. Even though the Department has a good knowledge of its overall communications costs, it does not track costs for application systems use. An exception was made for the Canadian Switched Network, for which costs are shared with the United States. Those costs accounted for about 23 percent or \$7.5 million of the total communications costs. The Department could estimate a representative cost and has very good knowledge of the factors that affect cost, but special cost studies have to be carried out each time detailed information is required.

35.65 Local area networks are computer systems based on connected groupings of small computers or workstations that share software, databases and network resources, such as printers. Networks can be local or national in their scope, or in one office or a single building. In 1994 most of the Department's personal computers were linked in local area networks, and larger metropolitan area networks were planned. The Department had not taken full advantage of its investment in local area networks. We recommended that the Department review network management policies and practices and make them consistent with a technology that might need updating every 36 to 48 months, and establish standards centrally to be distributed quickly. We also recommended that network support personnel be adequately trained to perform their duties. The Department agreed with those recommendations.

35.66 We found that the Department is now circulating draft policies for senior management review. Practices have been improved by building local area networks

by site instead of by organizational group, service environment or application. Commands and bases plan to implement this approach. The Department approved an information management training policy, identifying missing competency skills for each individual. The policy has been partially implemented in National Defence Headquarters. The number of training courses for systems administrators has increased by 300 percent and attendees by 222 percent in 1995–96, compared with 1993–94.

35.67 The Public Accounts Committee recommended that the Department approve the proposed plans for increasing the savings from its Integrated Data Network and report to the Committee on the savings realized. The Committee also recommended that the Defence Information Service Organization (DISO) be given the resources and authority to manage the Department's information technology effectively.

35.68 DISO was given the appropriate authority and new responsibilities and is now responsible for technology information, such as the software, hardware and communications environment. DISO is one of the three entities that has the authority to develop long-term capital plans for Treasury Board approval. The organization is developing the management framework for all departmental information holdings.

35.69 Command and control information systems. Perhaps the most important use of information technology in a defence department is the control of military operations. Military organizations use command and control information systems to communicate, manage and manoeuvre troops deployed in the field. In 1994 we found that command and control information system projects had been developed in isolation and had limited

Progress has been slow in fully developing and funding plans for telecommunications and computer operations.

**The Land Force
command and control
information system
will not be fully
interoperable with
Maritime and Air
systems before 2001.**

ability to interoperate. We recommended that "joint" standards be used to develop all command and control systems and that concepts and specifications for new systems require that they be able to communicate in joint and combined operations and to survive on the battlefield. The Department agreed with the recommendation.

35.70 We found that most of the command and control systems being developed within the Department will provide full interoperability for joint and combined operations. This is being achieved through the Department's participation in a United States initiative referred to as the Global Command and Control System (GCCS). The Department is adopting the GCCS standards and architecture for all headquarters.

35.71 The Department, however, is taking a different approach for the Land Force. It is presently seeking Treasury Board approval for the Land Force Communication System (LFCS) project in order to implement the SIC-F CCIS product from the French military. This \$180 million project will not be fully interoperable with the GCCS before 2001. Initially, it is being designed to accommodate only E-mail and structured message-transfer with other systems, the lowest levels of interoperability. Officials told us that this system more closely meets their requirements and would also save money. The Department is committed to full interoperability between LFCS and other systems by 2001, but at

the time of our audit no technical plan for this goal was in place.

35.72 The Public Accounts Committee made two recommendations to which the Department agreed. The Committee recommended that the Department make its command and control information systems interoperable as soon as possible. The Committee also recommended that the Department inform the Committee as soon as systems are interoperable, but not later than April 1996, or provide a report explaining the reasons for the delay and indicating the anticipated date for the implementation of the interoperable system.

35.73 The Department's response stated that the goal had been partially achieved by defining the four levels of interoperability and establishing a program to address the issue. According to the Department, levels one and two will be achieved by 1997-98 and levels three and four by 2000-01. It states that these levels will be achieved through the establishment of a Common User Core set of products and standards. As noted already, the Land Force project will not be included in the Common User Core set of products and standards, but officials told us that the Land Force system would use as many Common User Core elements as was cost-effective.

***Department's response:** With respect to the observations on interoperability, as stated, the Department has imposed specific constraints to ensure that the Land Force Command System is fully interoperable with other Canadian Forces command and control systems by 2001.*

Infrastructure Reductions — 1994, Chapter 26

Background

35.74 In 1994–95 the Department had a budget of \$11.5 billion to deliver its Defence Services Program. The bulk of the budgeted departmental activity takes place at 30 military bases and other related facilities. The configuration of infrastructure has a great impact on local economies and the cost effectiveness of defence services. The Department's infrastructure should be based on military requirements identified in 15-year force structure plans. Experience in Canada and from other countries indicated that savings could be made while respecting political realities.

35.75 Chapter 26 of our 1994 Report recommended that, based on its long-term force development plans, the Department advance its development of a comprehensive, fully integrated strategy for portfolio management and investment to define the optimum infrastructure for the total force; requirements for new infrastructure, replacements and disposals; and maintenance strategies. The Department's response to our recommendation deferred an additional detailed assessment of facilities pending the Defence Policy review (the 1994 Defence White Paper was issued in the fall of 1994). We also recommended that the government consider an independent process, open to public scrutiny, for base closures or reductions. Cost/benefit studies of proposed financial assistance to affected communities should be conducted. As this recommendation was directed to the government, the Department did not respond to it.

Conclusion

35.76 Progress on infrastructure rationalization has been satisfactory. The process for determining new and replacement infrastructure requirements should improve the timeliness and cost effectiveness of construction projects. Progress has been slow in developing maintenance strategies.

Observations

35.77 Our 1994 chapter referred to a 1975 study that assessed the minimum infrastructure needed to support the Canadian Forces at 12 bases; there were then 32. At the start of our audit, there were still 30 bases. Before the publication of our audit report, the 1994 Budget announced the closure of four bases, and the reduction or consolidation of several others.

35.78 The 1995 departmental Budget Impact Statement defined the operational needs of the Canadian Forces as :

- a “naval and maritime air presence on the Atlantic and Pacific coasts;
- a land force presence in all four regions of Canada;
- eastern and western fighter aircraft bases; and
- eastern and western air transport bases.”

35.79 The Impact Statement stated that certain training facilities would be required but was not specific. The Statement analysis was very similar to the 1975 study analysis of requirements. This document also stated: “While the closure of bases and units has a significant impact on local communities, the government

The Department has defined the optimum infrastructure for its total force. It has made significant strides toward achieving its goal.

The government has taken the position that an open process for base closure is too time-consuming given the size and immediacy of budget reductions.

must proceed with further reductions in defence infrastructure to bring it in line with the military requirements of the smaller force set out in the White Paper.”

35.80 We found that, in terms of type and number of bases being kept, the Department is close to reaching its goal. We discussed the status of bases kept open but not covered under the Budget Impact Statement, and obtained explanations from officials. Air Command headquarters are being amalgamated in Winnipeg to form a single-level headquarters, to be known as 1 Canadian Air Division/Canadian NORAD Region Headquarters. This was not foreseen and savings are not expected. Since our allies pay their share of annual costs at the training bases they use, the Department's officials told us that they do not anticipate significant savings from closing these facilities. However, total cost figures were not available in the Department. Officials also told us that the Department has no immediate plans to change the status of Montreal, Moose Jaw or Gander.

35.81 The closure and consolidation of bases has created a need for new

infrastructure at remaining bases. Other new infrastructure, replacements or disposal will be managed through the new Defence Resource Management System, which relies on the business planning process. This process now permits the global approval by the Treasury Board of a number of replacement construction projects at the same time. This should go a long way to improving the timeliness of their implementation. Officials told us that once performance indicators are developed for infrastructure maintenance, maintenance strategies will be developed and integrated with capital plans.

35.82 Both our chapter and the Public Accounts Committee recommended that the government develop a process for rationalizing the Department's infrastructure that is as open and transparent as possible and allows every opportunity for consultation with those likely to be affected. The Minister's response to the Committee was: “The magnitude and immediacy of the budget cuts do not permit such a time-consuming approach.”

Infrastructure Management — 1994, Chapter 27

Background

35.83 The Department of National Defence manages the largest portfolio of property in Canada. The replacement value of departmental buildings and works is more than \$17 billion, without assigning any value to the land. The Department's infrastructure must support defence activities as reflected in the 15-year strategic plan. Our 1994 audit addressed construction management, operations and maintenance, and environment management. The audit focussed on National Defence buildings, properties and works. Leased office facilities were not included in the audit scope.

Conclusion

35.84 Significant progress has been made in construction management. A full response to our recommendations depends on the successful implementation of business planning at command and base levels. With regard to the management of infrastructure operations, studies have been undertaken to address identified problems concerning the 10-year backlog of infrastructure projects and deferred maintenance. Decisions are pending until completion of those studies in 1997. Alternative service delivery has been considered by almost all of the bases for their construction engineering functions. The Housing Agency intends to pay back operating losses on married quarters from future surpluses. It has identified the direct costs of support to non-public activities, but has not allocated indirect costs. Departmental plans and budgets still do not identify all clean-up costs to comply with environment regulations. The Department is making slow progress in developing infrastructure information

systems required by each management level.

Observations

Construction management

35.85 Chapter 27 of our 1994 Report observed that the Department spent about \$200 million every year on major construction projects to replace existing infrastructure, and an additional \$70 million yearly on minor projects. We found that high-priority construction projects that were part of the National Defence Headquarters initiative — the Infrastructure Adjustment Program — were within budget and on time, while major construction projects suffered some weaknesses in the management of their early phases. We were concerned about the delay in delivering replacement structures, and recommended that the Department strengthen needs and requirements analyses for major replacement projects, consistent with force structure and base development plans. We also recommended that in setting its priorities it take into account the optimum savings to be achieved in construction projects, and ensure that first phases of the projects are performed in a timely manner; that it track the inventory of projects in the predevelopment phase for force development planning; and that it revise policies and practices to conform to Treasury Board policy on capital spending. The Department concurred with our recommendations. It stated that infrastructure was managed to support operations best and that operational need was the main determinant of funding priority.

35.86 Significant action has been taken on these recommendations. Under the Department's new system, projects

originate with the departmental business plan, which in turn is based on command and eventually base business plans. These plans link the Department's program subactivities to departmental performance, and seek to provide a framework between assigned resources and expected results.

35.87 National Defence Headquarters now implements projects using a revamped project-oriented organizational structure and streamlined approval processes, and is trying to incorporate many innovative practices into the delivery of construction projects. The initiatives should improve the needs and requirements analyses, and the timeframes of projects. In addition, business cases now are key to decision making in projects, as the Department endeavours to evaluate a broad range of delivery options, including opportunities to save money. A limited review of project documents indicates that project staffs are still developing the expertise needed to do the necessary financial analysis for the business cases.

35.88 Our follow-up did not assess a sufficient number of projects to form a complete opinion on the effectiveness of the Department's new approach. However, the Department has made significant changes that should result in greater value for money in construction. A full response to our recommendations depends on successful implementation of business planning at the command and base levels. Business planning is necessary to provide the information for ensuring that only the most defence-worthy, cost-effective construction projects receive funding.

35.89 The Department is still using maintenance funds to recapitalize and rejuvenate its infrastructure. Officials told us that appropriate policy changes will be implemented by the end of fiscal year 1996-97. Until then, the Department will

not be able to introduce proper life cycle management of its infrastructure.

35.90 The Public Accounts Committee made two recommendations related to maintenance capital spending policies. The first recommendation suggested that the Department take immediate steps to bring its policies on recapitalization into conformity with existing Treasury Board policy. The second recommendation suggested that, until the Department's policies on recapitalization are harmonized with Treasury Board policy, the Department adhere to the Canadian Institute of Chartered Accountants standards on capital assets. The Department is not yet complying with accounting standards.

Management of infrastructure operations

35.91 In 1994 we found that the Department often deferred maintenance, leading to loss of performance or asset value, or to more expensive repairs later on. We recommended that the Department introduce life cycle management for major elements of infrastructure to determine the most appropriate balances between capital and maintenance spending and to use information in infrastructure planning. We also recommended that deferred maintenance be addressed at the same time as the Department rationalizes its infrastructure to meet force structure needs, and that the Department consider using savings from improved efficiency in operations to reduce the amount of deferred maintenance. We reported that, based on studies conducted by the Department since 1980 and confirmed by our own study, the productivity of the construction engineering function was low. To correct that problem, we recommended that the Department have access to better information for decision making on infrastructure maintenance,

Although significant progress has been made in construction management, the Department is still using maintenance funds to recapitalize and rejuvenate its infrastructure.

develop a national strategy for dealing with human resources and gain union co-operation. We also recommended that the Department compare its construction engineering functions at each base with other service providers, and look to other countries for areas and methods of introducing competition for support services. The Department concurred with our recommendations. The 1994 Report also stated that married quarters needed to be streamlined to eliminate significant operating losses. To do so, we recommended that the Department study, with a sense of urgency, the military and financial benefits of married quarters in relation to program objectives, and end operating losses to the Crown on married quarters. Finally, we reported that non-public-fund facilities required cost controls in order to be operated "at minimum public expense", and that information should be reported in the budget process. The Department concurred with those recommendations.

35.92 The Public Accounts Committee recommended that the Department actively explore ways to cut the costs of maintenance services, such as contracting services out to the private sector or exposing in-house services to competition. The Committee also requested the Department to report on its cost reduction objectives and the savings realized.

35.93 The Department reported to the Committee on its Alternative Service Delivery initiative and personnel reductions in headquarters staff; however, its response does not refer to any savings. A pilot study on alternative service delivery was conducted at the Construction Engineering section at Canadian Forces Base Kingston. Estimates of cost savings were between 40 to 60 percent. However, a more conservative figure received from a large

prime contractor indicated 10 to 20 percent cost savings. The Department still has to clearly and fully enunciate its cost reduction objectives, the expected savings and the timeframe.

35.94 The Department initiated an in-depth review of the 10-year backlog in infrastructure projects identified in 1994. Since that time, the government's closure and reduction of military bases has reduced the backlog. The Department should complete its maintenance backlog study for the remaining infrastructure by July 1997. Adequate infrastructure information appropriate to each level will be included in business planning as a mechanism for improving maintenance management. The Department is maintaining regular communication with affected unions and appears to be effectively managing the relationship.

35.95 Although many of the facilities requiring maintenance are on bases that have been closed, the Department has still not resolved the issue of deferred maintenance. A working group has been established and the Department has initiated a project to design a performance measurement system based on a facilities condition index. This project is scheduled for completion by July 1997. Once the system is operational and deferred maintenance has been identified, the Department intends to provide command commanders with the available resources to attack the problem.

35.96 Senior officials told us that the process of comparing construction engineering functions with those of alternative service providers, and streamlining and contracting-out support services has been implemented for all but one base. A complete review of the business process has been done and core functions have been defined. Resource reduction goals have been set to 1999.

Bases are considering alternative service delivery for their construction engineering functions.

The problems posed by a 10-year backlog in infrastructure maintenance projects identified in our 1994 chapter cannot be resolved until a study is completed in 1997.

However, no statistics are yet available on the total amount of work put to competition, and the total savings, if any, that have been achieved. Officials also told us that many informal meetings continue to be held with union representatives to keep workers informed and obtain their support for these initiatives.

35.97 Housing. In 1994, we reported that the Department owned approximately 22,000 dwellings and leased an additional 2,000 units under bulk lease from the private sector to house Canadian Forces personnel and their dependants at 36 bases and stations. The Department estimated that the replacement value of the entire housing portfolio is approximately \$2 billion.

35.98 Married quarters are still losing money and may do so until 1998–99, according to the management of the newly created departmental special operating agency, the Canadian Forces Housing Agency. However, the Department recently decided that any shortfalls will have to be repaid out of future Agency revenues.

35.99 The Canadian Forces Housing Agency does not own the departmental housing, but acts as operator and maintainer. Currently, the Department retains ownership of the housing and related lands but it can seek the Treasury Board's approval to transfer this ownership to the Agency. Overall policy on the provision of housing remains a departmental responsibility and the Agency is responsible only for operating policies.

35.100 During the first two years of operation, the Agency plans to review and determine the operational housing requirements at all bases, develop housing policies and implement its business

planning process to the base level. Comprehensive studies of the housing requirements have been done for Canadian Forces bases at Comox, Edmonton and Esquimalt. These studies identified the quantity and type of housing required and the extent to which this could be provided by the private market or the Department. Management intends to study the housing requirements at each base using a similar methodology.

35.101 Senior management is making a serious commitment that 1998–99, at the latest, will be the break-even year. It told us that this will be accomplished by using the discretionary power of management to allocate resources. If revenues do not cover expenditures, management will defer maintenance and provide only what is absolutely necessary.

35.102 As the Canadian Forces Housing Agency has been in operation only since 1 April 1996, we cannot comment on whether it will be successful. This Agency is committed to providing suitable and affordable housing on a financially self-sustaining basis. The Agency's business plan describes how it will do this. However, there are elements of the business plan that raise concern:

- Base closures and downsizing of the military have not been taken into account in the Agency's business plan. Chronic vacancies at specific sites could affect the ability of the Agency to manage its housing. While this problem could be solved by disposing of housing stock, the Agency does not own the housing portfolio and does not have the power to sell any of its housing stock at this time. Departmental officials told us that the Canadian Forces Housing Agency will be returning to the Treasury Board in the near future to seek additional authority.

- The forecast expenditure and revenue figures in the business plan are not based on the housing requirements at

Operating losses on married quarters identified in 1994 may not end before 1998–99.

each base. The housing requirements for all bases have not yet been determined.

- Grants in lieu of taxes, paid to compensate for services provided by municipal governments, are not included in the forecast expenditure and revenue figures in the business plan. Management estimates that grants could be \$20 million or more. The Agency management was not aware that following the devolution of the budgetary responsibility for grants in lieu of taxes to the Department on 1 April 1997, future increases in these grants will become the responsibility of the Department. Departmental officials told us that future business plans of the Canadian Forces Housing Agency will take this change into account.

- Only one member of a Management Advisory Board, set up to provide advice and guidance to the Canadian Forces Housing Agency, has practical and extensive experience in management of a large housing portfolio.

35.103 The Public Accounts Committee recommended that the Department redraft its business plans for the Canadian Forces Housing Agency in order to end the losses on its married quarters sooner than fiscal year 1997–98, and report to the Committee by January 1996. The Committee also recommended that the Department and the Treasury Board act to establish a special operating agency on an urgent basis. The Department agreed with those recommendations.

35.104 The Department has since responded to the Committee that it sought Treasury Board approval of the Canadian Forces Housing Agency as a special operating agency in March 1994. However, the resolution of issues required for Treasury Board approval of a provisional special operating agency took until October 1995. Consequently, the implementation of the Agency was delayed from the original plan and the

deficit reduction target recommended by the Public Accounts Committee is not achievable. The Department stated that the Agency's management has taken a more aggressive approach to cost reduction than appeared in the original business plan. A break-even position is foreseen for 1998–99, three years after the Agency's start-up, instead of the four years required in the initial plan. The new plan will also reduce operating costs directly, which will result in greater net savings than the original plan reviewed by the Committee. In addition, the Department has decided to repay any operating shortfall from future surpluses.

***Department's response:** The Department generally agrees with the comments on infrastructure management. However, we disagree with the assertion that losses on married quarters may not end before 1998–99. The Department's recent decision to treat any Agency shortfall as temporary and repay it out of future revenue will ensure that losses on married quarters will no longer be paid out of public funds.*

35.105 Non-public-fund activities.

Through its Personnel Support Programs, the Department provides recreational and community services and facilities for military and family needs. As prescribed by Treasury Board guidelines, the costs of these programs are shared by the Crown and the military community. In 1994, we counted 36 non-public-fund activities that received some public support for utilities, materials, construction and administration. At the time, the Department could not tell us the extent of its financial support to non-public-fund activities.

35.106 The Department estimates that the direct cost of public support to non-public-fund activities in 1994–95 was \$40.2 million: \$22.4 million for personnel, \$12.8 million for accommodation and almost \$5 million for capital expenditure.

More than \$500 million will be required by the Department over a 10-year period to comply with environmental regulations. Additional sites still need to be surveyed and investigated to determine clean-up methodology and cost.

The figures for 1995–96 will be available in September 1996. Not included in this amount is an allocation of cost for the time spent on non-public-fund activities by personnel such as the base comptroller or base administration officer.

35.107 The Treasury Board guidelines specify that non-public-fund activities are to be operated at minimum public expense. In that respect, the Department has conducted a strategic review of the personnel support program. Officials advised that as a result of the review, the Department has approved the formation of a Personnel Support Agency with full implementation by 1998–99, the purpose of which is to deliver personnel support programs in a more cost-effective manner. The Department expects that this initiative will substantially reduce the number of military personnel employed in support of non-public-fund activities, and save 20 to 25 percent of personnel costs.

Environment

35.108 Experience has proven that military activities have the potential to damage the environment. Departmental activities must be conducted in accordance with environmental regulations, including proper estimation of clean-up costs. In 1994, we found that environmental clean-up and prevention projects were not all included in departmental plans, and that senior management was not given a full picture of total environmental projects and costs in order to assess the feasibility of the environmental program. We recommended that departmental plans and budgets recognize all costs identified by departmental studies, and clear accountability be established for achieving all levels of environmental plans. Information should be reported in Part III

of the Estimates. The Department agreed with our recommendations.

35.109 Departmental staff now provide information to senior management about the Department's clean-up program for three separate types of activities. First, for active bases, staff report on environmental issues and estimated costs to clean up and monitor sites using a new risk management approach to site remediation. Where contamination is not likely to immediately impact on the environment or people's health, the site may be monitored or managed over the long term rather than cleaned up. This approach reduces both the cost and the amount of time that would otherwise be required under the total remediation option. Under this approach, the current estimate for environmental cleanup of active bases is \$190 million over a 10-year period. The second type of activity for which environmental information is provided is decommissioned bases, where environmental clean-up, including unexploded ordnance, may require 10 years of work at an additional estimated cost of \$107 million. The third type is the Distant Early Warning (DEW) Line sites for which the Treasury Board approved the expenditure of \$242 million over a 10-year period to clean up. This amount includes the cost of both remediation and monitoring. An additional nine years will be required for monitoring.

35.110 We noted that for active ranges, unexploded ordnance has not been included in the total environmental clean-up cost. The Department explained that these active ranges will continue to be used and that more ammunition will be fired in the future to satisfy ongoing military training requirements. The Department has clean-up procedures and standards for unexploded ordnance but

does not have criteria for the explosive material residues. Environmental costs related to the removal of unexploded ordnance on one decommissioned base to be transferred to a third party are not included. The clean-up cost of unexploded ordnance at the Harvey Barracks in Calgary will be about \$13 million.

35.111 The Department reported on its Incremental Environmental Program in the 1996–97 Part III of the Estimates. All commanders and managers will be directed to incorporate environmental issues into their business plans.

35.112 Clean-up costs over the medium term are estimated at about \$500 million. This does not include the sites that have yet to be surveyed and investigated to determine the level of contamination, cost and clean-up methodology. The Department's officials told us that field surveys will be completed by March 1997.

Major departmental information systems

35.113 We examined the Department's three major information systems supporting infrastructure management: a property record system (CEMIS I), a base-level work control system (CEMIS II), and a maintenance effectiveness tracking system (MES). We found that those systems could not provide the effective life cycle management information required in the long term. In 1994, the Department agreed with our recommendations to implement, where appropriate, information systems that support life cycle management of individual structures, buildings systems and works; and to ensure that business plans provide a strong accountability framework to match delegation of authorities.

35.114 The challenge for the Department is to ensure that adequate infrastructure information systems are available at the appropriate management level. For example, the Department has yet to develop reliable performance measures for its infrastructure activities, to introduce policies that adequately differentiate capital and maintenance spending, to rework significantly its new base-level information system, to develop new mechanisms for "rolling-up" base-level information to higher levels, and to implement controls to ensure the consistency and reliability of information. The Department is making slow progress in meeting these challenges. Officials told us that performance measures are being developed and should be in place by 1997. In addition, a strategic plan for information management is being written and should be completed by the time this audit is reported. The Department plans to have a new information system in place by 1999.

35.115 In 1994 we noted that the delivery of infrastructure services was often divided among several departmental functions, different departments or even different levels of government. For example, we reported that the Department was providing municipal services to defence properties where Public Works and Government Services was already paying the local municipality for some of the same services.

35.116 To have a strong accountability framework, the Department must first have information concerning inputs and outputs. As we note in our chapter on Defence Support Productivity, departmental managers still lack cost and performance data upon which to build the framework. So far, the Department has implemented business planning only down to the command level — not the base

The Department is making slow progress in developing infrastructure information systems required by each management level.

**Municipalities,
National Defence and
Public Works and
Government Services
continue meeting to
discuss the issue of
grants in lieu of taxes
addressed in our 1994
chapter.**

level where most of the delivery of infrastructure services takes place.

Grants in lieu of taxes

35.117 Grants in lieu of taxes are paid to municipalities under the *Municipal Grants Act*, administered by Public Works and Government Services Canada. The 1992 estimate of grants in lieu of taxes for the Department's properties was close to \$110 million for municipal and school services. However, some bases provided many of the same type of services in order to meet the Department's own standards. In four bases we found that these services — recreation, firefighting and protection, garbage removal, snow removal and street cleaning — represented, on average, approximately 30 percent of the grants in lieu of taxes already paid to municipalities by Public Works.

35.118 We recommended that the departments of National Defence and Public Works and Government Services jointly review the legislative and administrative frameworks for the grants in lieu of taxes paid for defence properties, with a view to clarifying accountability, ensuring maximum co-operation with municipalities and minimizing overlap of services provided by National Defence and the municipalities. The Department's response confirmed that officials were already working on this issue with their counterparts within existing legislative and administrative frameworks. Public Works and Government Services agreed with the recommendation but raised the point that the accountability issue was not restricted to National Defence. It specified that changes in ministerial responsibility could well require legislative amendment. The amount of grants paid by the Government of Canada on properties where municipal-type services are

provided by the Department would be considered in the context of the overall review of the program.

35.119 In April 1997 the municipal grants statutory vote will be allocated to the operating budgets of departments that administer real property. Consequently, National Defence will have a budgetary responsibility for the amount of grants in lieu of taxes owing to municipalities. Public Works and Government Services will still be the department in charge of paying the grants in lieu of taxes and in negotiating with municipalities the amounts to be paid.

35.120 The Department of National Defence intends to pass these moneys down to base commanders. Public Works officials are meeting with base commanders or their representatives to inform them of the type and amount of services they can reasonably expect from municipalities. Progress with the municipalities is slow because many parties must agree on the level of service that municipalities should provide.

35.121 The Public Accounts Committee recommended that: the Department report to the Committee on the results of its review of the new procedures that have been developed to improve communications between it and Public Works and Government Services Canada on matters of grants in lieu of taxes and municipal services; steps be taken to charge grants in lieu of taxes directly to the budgets of the Department's facilities for which these grants are paid; the Department transfer greater control of base expenditures for municipal-type services to base commanders; and the Department inform the Committee by January 1996 on new responsibilities that have been transferred to base commanders. The Department agreed with those recommendations.

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Chapter 36

Revenue Canada and Department of Finance –
Goods and Services Tax:
New Housing Rebate and “Self-Supply”

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Revenue Canada – Enforcing the
Income Tax Act for Large Corporations



November 1996

This November 1996 Report comprises 19 chapters, including “Matters of Special Importance”, as well as a Foreword and the Main Points from the May, September and November 1996 Report chapters. In order to better meet clients’ needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.

Chapter 36

**Revenue Canada and
Department of Finance**

Goods and Services Tax — New
Housing Rebate and “Self-Supply”

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants.

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Revenue Canada and Department of Finance

Goods and Services Tax — New Housing Rebate and “Self-Supply”

Main Points

36.1 The treatment of residential real property transactions under the Goods and Services Tax (GST) is a matter of considerable complexity. This complexity is at the root of much of the non-compliance with the law and of the administrative difficulties that occur in this area.

36.2 Proposed technical amendments related to residential real property that were announced by the government on 23 April 1996 promise to address certain areas where non-compliance or unintended results are occurring. However, administration of the New Housing Rebate program is faced with difficulties that may require legislative change or additional interpretive guidance by Revenue Canada to resolve. A program evaluation of the New Housing Rebate program would provide valuable input for consideration of these matters.

36.3 Revenue Canada directs fairly strong audit efforts toward New Housing Rebate payments for “owner-built” homes, but its efforts directed toward rebates paid for “builder-built” homes are much weaker. While the former rebates are higher-risk, the latter are not free of non-compliance risk and, in total, are far more significant to the federal treasury (\$218 million out of a total of \$303 million in New Housing Rebate payments for the year ended 31 March 1996).

36.4 Revenue Canada’s information systems cannot currently provide much of the information needed to manage the New Housing Rebate program.

36.5 One of Revenue Canada’s Tax Services Offices conducted a successful audit project aimed at non-compliance with the “self-supply” rules pertaining to multiple-unit residential complexes. This project may be worth replicating in other areas of the country.

36.6 There is some concern that a provision of the *Excise Tax Act* that is meant to provide equitable treatment for unincorporated professional builders who construct homes for their personal residences may be used by small-scale builders to build homes for resale in a manner that avoids the GST. While Revenue Canada’s assessments against such builders have, for the most part, been upheld by the Tax Court of Canada, the Department and the Department of Finance continue to monitor the situation.

36.7 Revenue Canada’s policy on voluntary disclosure does not provide a great deal of encouragement for builders who have not complied with the self-supply rules to come forward and bring themselves into compliance.

Introduction

Application of the GST to residential real property transactions is complex

36.8 The general rules for the application of the Goods and Services Tax (GST) to residential real property transactions are that sales of new residential complexes (including individual homes) are taxable while sales of used residential complexes and rentals of residential complexes are exempt from tax. In addition, a partial rebate of the GST paid is available to those who purchase new residential complexes for their personal occupancy at prices below certain thresholds (see Exhibit 36.1). The purchaser may assign the rebate to the builder from whom the residential

complex was acquired. (Strictly speaking, the *Excise Tax Act* provides that “the builder may pay or credit the amount of the rebate, if any, to or in favour of the individual.” For ease of reference, in this report we follow common usage and refer to the arrangement as an “assignment”.)

36.9 The general rules are supplemented by numerous special rules to deal with particular situations. This is a reflection of the variety and complexity of transactions and circumstances involving residential real property. Differences in provincial real property laws contribute to the complexity and create a challenge for Revenue Canada to ensure that the GST is applied so that its effects are similar in all provinces. In the Province of Quebec, the GST is administered in accordance with

There are three principal categories of the GST New Housing Rebate, each calculated by its own method.

1. Basic

The basic category applies to rebates claimed for GST paid on new or substantially renovated housing purchased from a builder, for GST paid for a home constructed or substantially renovated by the owner, or for GST paid on a new mobile home or new floating home purchased from the manufacturer, distributor or retailer.

The New Housing Rebate is calculated as 36 percent of GST paid up to a maximum of \$8,750. For homes with a fair market value of \$350,000 and over, the amount of the rebate is clawed back using a formula that will cause the rebate to equal \$0 when the ceiling value of \$450,000 is reached.

2. Housing Built on Leased Land

This category applies to rebates claimed for new housing where the building was purchased on land leased from the builder. The lease must be at least 20 years' duration or contain an option to purchase the land.

The New Housing Rebate is calculated as 2.34 percent of the total amount paid for the building, up to a maximum of \$8,750. For homes with a fair market value (including the fair market value of the land) of \$374,500 and over, the amount of the rebate is clawed back using a formula that will cause the rebate to equal \$0 when the ceiling of \$481,500 is reached.

3. Co-operative Housing

The rebate claimed is for the purchase of a share of the capital stock of a co-operative housing corporation.

The New Housing Rebate is calculated as 2.34 percent of the total amount paid for a share of the capital stock, up to a maximum of \$8,750. For a share with a fair market value of \$374,500 and over, the amount of the rebate is clawed back using a formula that will cause the rebate to equal \$0 when the ceiling value of \$481,500 is reached.

Exhibit 36.1

GST New Housing Rebate

Much of the non-compliance that Revenue Canada encounters can be attributed to the complexity of the provisions.

The basic purpose of the New Housing Rebate is to maintain, under the GST regime, roughly the same tax burden associated with the former Federal Sales Tax.

Revenue Canada’s direction by the Ministère du Revenu du Québec (MRQ). Our audit was confined to Revenue Canada’s areas of responsibility and thus excludes the MRQ.

36.10 Much of the non-compliance with the residential real property provisions of the *Excise Tax Act* that Revenue Canada encounters can be attributed to the complexity of the provisions. Because Canada’s tax system is based on the principle of self-assessment, full voluntary compliance requires that taxpayers/registrants know how to comply. The more complex the rules, the greater the likelihood that some non-compliance will occur simply due to ignorance or misunderstanding of the law. Many people and businesses enter into residential real property transactions only infrequently — some are individuals buying homes; some are individuals or businesses who are involved in “one-time” ventures. Often, timely completion of transactions is important and people carry them out without having first explored their tax implications. Even among businesses that operate regularly in the residential real property sector, many are small enterprises that may not have ready access to tax expertise.

36.11 Another consequence of complexity is that taxpayers/registrants who try to comply with the law incur higher compliance costs in connection with their efforts. Compliance costs include expenditures for acquiring knowledge of the tax system; compiling data on tax paid and tax collected; preparing and submitting tax returns; professional advice; and incidental costs such as postage, telephone, overhead and storage costs.

Focus of the audit

36.12 The objective of our audit was to examine the application of the GST to residential real property transactions in order to identify areas where there is significant risk of non-compliance or of difficulties in achieving program objectives. We focussed on two such areas: administration of the GST New Housing Rebate and of the self-supply rules applicable to multiple-unit residential complexes. We also examined how Revenue Canada and the Department of Finance respond to this risk.

36.13 Further details on the audit objective, scope and criteria are presented at the end of the chapter in the section **About the Audit**.

Observations and Recommendations

New Housing Rebate

36.14 Background. Revenue Canada’s records show the value of New Housing Rebate payments for all of Canada to be \$303 million for the year ended 31 March 1996. The basic purpose of the GST New Housing Rebate is to maintain, under the GST regime, roughly the same tax burden associated with the former Federal Sales Tax (FST) for sales of low- and moderately priced new homes. The GST applies a tax rate of seven percent to a broad base of goods and services. Its predecessor, the FST, applied higher tax rates (9 percent for construction materials and 13.5 percent for other taxable goods) to a tax base that was narrower than for the GST (because the FST did not apply to construction services). With respect to new residential complexes, the tax burden under the FST was lower than the burden that results under the GST. However, after

taking into account the relief provided by the GST New Housing Rebate, the net tax burden under the GST is meant to approximate what the government believed was the average tax burden under the FST (approximately 4.5 percent).

36.15 The GST New Housing Rebate is generally 36 percent of the GST paid on the purchase of a new residential complex. The calculation varies somewhat for particular types of residential complexes, for example, where shares in a housing co-operative are involved. The rebate is subject to a threshold (\$350,000 in the typical case) above which the amount of the rebate is reduced. This means that the maximum rebate is \$8,750. At a purchase price of \$450,000, the rebate is zero. This “clawback” provision reflects the government’s desire not to provide relief to owners of higher-priced new homes. A technical paper issued by the government prior to the introduction of the GST stated the government’s intention to review the threshold at least every two years so that it could be adjusted to reflect changes in economic conditions and housing markets.

36.16 The GST New Housing Rebate is available to the purchaser of a new residential complex. However, the law allows a purchaser to assign the rebate to the builder (vendor) of the new residential complex. This is apparently intended to relieve the purchaser of the need to obtain financing for the full purchase price; instead, the purchaser needs to finance only the purchase price net of the rebate.

Proposed technical amendments extend availability of New Housing Rebate

36.17 Subject to the clawback provisions, the GST New Housing Rebate is intended to be available for purchases of new residential complexes. However, in practice, certain types of new residential complexes were excluded because they

did not fall within the precise categories provided for in the legislation. Often, this was due to transactions being structured to meet unique requirements of provincial legislation and the particular structure putting the transaction “off side” with respect to the technicalities of the *Excise Tax Act*. We noted a number of such situations in our audit. The proposed technical amendments announced by the federal government on 23 April 1996 include provisions to correct some of these anomalies (Exhibit 36.2).

36.18 However, a number of other administrative challenges remain that may require correction by future legislative amendments or the issuance of policy statements by Revenue Canada. These will be discussed in the remainder of this section. Out of 183 GST-related policy statements issued by Revenue Canada, 28 deal with real property issues. Seven more policy statements on real property issues are currently being prepared. Clearly, the real property sector, which includes the New Housing Rebate, is extremely complex and troublesome for registrants, claimants and tax administrators alike.

Enforcement of “boundaries” takes a great deal of effort

36.19 Eligibility for the New Housing Rebate is restricted. The *Excise Tax Act* and Revenue Canada’s administrative policies set out rules on who may receive the rebate and the kinds of housing and real-property-related taxable expenditures for which the rebate will be paid. There are also rules on when a New Housing Rebate claim may be made and on the maximum amount of the claim that is allowable. Each of these rules establishes an important “boundary”. On one side of the boundary, a rebate will be paid; on the other side, it will not be paid or will be paid in a reduced amount. The existence

The proposed technical amendments announced by the federal government include provisions to correct certain anomalies.

Despite the Department's attempts to clarify its meaning and application, the term “substantial completion” remains a source of disputes.

of such boundaries makes it necessary for Revenue Canada to expend effort to ensure that they are observed. In some cases, it also provides an incentive for recipients to engage in tax planning activity to ensure that they maximize the amount of their rebate.

36.20 One such boundary relates to the term “substantial completion”, particularly as it applies in situations where owners of property build a residence or have one built for them. The *Excise Tax Act* stipulates that an owner-builder may apply for a New Housing Rebate within two years of “substantial completion” of the residential complex. There is no definition of the term in the Act and, despite the

Department's attempts to clarify its meaning and application in policy statements, it remains a source of disputes in the context of audits and appeals. Revenue Canada uses the administrative guideline that a complex must be at least 90 percent complete to qualify as “substantially complete”. Engaging in such disputes involves compliance costs for claimants and administrative costs for Revenue Canada.

36.21 To illustrate the significance of this matter, we present two hypothetical situations in which an owner-builder engages in tax planning to obtain the most generous rebate possible. (We use an owner-builder in these examples because, in practice, most of Revenue Canada's

Exhibit 36.2

GST Changes Relating to Residential Real Property

A number of the measures in the 23 April 1996 Notice of Ways and Means Motion were proposed to simplify the GST system, make it fairer and clearer and ease compliance for Canadians. The following are relevant to the topics covered in this chapter.

GST New Housing Rebate

The changes related to residential real property are proposed to address the problem of the current inequity of application of the housing rebates.

Residential Condominium Units — The GST New Housing Rebate is extended to include owner-built condominiums and condominiums built on leased land.

Time Limits — The time limit for filing all GST New Housing Rebate applications will be reduced to two years. Previously the time limit for rebates assigned to the builder was four years.

Mobile Homes — The definition of *mobile home* will be amended to reflect the additional types of mobile homes such as “mini-homes”. This amendment will allow purchasers of the previously excluded types of mobile homes to be eligible for the New Housing Rebate.

Eligibility for Rebate where Tax Not Paid — The application of the New Housing Rebate will be denied in situations where the builder is not required to self-assess and remit the tax because of another Act of Parliament or any other law.

Subsidized Housing

Subsidized rental housing refers to the construction or substantial renovation of a residential complex or addition for which the builder has received government funding. Under the proposed rules, the builder must calculate the tax payable on the greater of:

- seven percent of the fair market value of the complex at the time of the first rental;
- the total of all input tax credits claimed if a registrant; and
- the total of any special real property rebates if a non-registrant.

These changes will eliminate the current problem with subsidized housing where the fair market value was substantially below cost and resulted in significant tax loss.

audits of the New Housing Rebate focussed on owner-builders.)

36.22 We will explain the first hypothetical situation with the aid of a comparison. In the first scenario, a builder completes a house according to usual practice and sells it to a purchaser. The purchaser, either by choice or because he or she is unaware of the opportunity, does not order any “extras” prior to the sale and assigns his or her New Housing Rebate to the builder upon closing the deal. If the purchaser adds extras later, any GST paid on them is not rebatable because the amount of the rebate is based on the builder’s price to the purchaser. In another scenario, an owner-builder has the flexibility to incorporate extras (such as landscaping, deck and swimming pool) into the residential complex within two years of first occupancy and prior to declaring it substantially complete (at any point after 90 percent completion) and submitting a claim for the New Housing Rebate. These extras qualify for the rebate.

36.23 Where the fair market value of the house being built is expected to exceed \$350,000, the owner-builder may take advantage of the vagueness in the term “substantial completion” to avoid some or all of the clawback of the New Housing Rebate. Here, the owner-builder could declare that the house is substantially complete at a time when the fair market value of the house is less than \$350,000 but the house is 90 percent complete. Any further expenditures would then not trigger the clawback that occurs for new residential complexes whose fair market value lies between \$350,000 and \$450,000.

36.24 Another way to avoid the effects of the clawback for owner-built homes relates to the use of the concept of fair market value in the formula for

determining the amount of the clawback. We understand that the reference to fair market value is meant to ensure that the value of the land on which a house is situated is considered in the clawback calculation. This is apparently intended to deal with situations in which the land was not acquired in a recent market transaction, for example, land acquired by inheritance. However, the fair market value concept is applied to the entire residential complex and the fair market value of the residential complex may be lower than cost. This could happen where a high-cost home is built in an area that is not noted for expensive homes, and the fair market value determined on the basis of comparable sales would be lower than cost. For example, if the cost exceeded \$350,000 but the fair market value were less than \$350,000, the clawback would be avoided. One leading court case involved exactly this situation.

36.25 This problem is a variation of another problem that was recognized by the government and for which a solution is contained in the proposed technical amendments announced on 23 April 1996. That problem concerned the taxation of social housing projects. The self-supply rules applicable to projects of this type also make reference to fair market value — in this case, as a basis for calculating the amount of GST liability. However, because such projects are not subject to a “market”, the application of private-sector-oriented valuation techniques has routinely resulted in the assignment of fair market values that were substantially below cost. Since there have been many such projects, including some very large ones, the tax loss has been significant. The proposed solution is outlined in Exhibit 36.2.

36.26 It is difficult to estimate the extent to which situations analogous to the

It is possible to take advantage of the vagueness in the term “substantial completion” to avoid some or all of the clawback of the New Housing Rebate.

Potentially significant compliance and administration costs and tax planning opportunities suggest the need for an evaluation of the New Housing Rebate program.

illustrations presented in paragraphs 36.22 to 36.24 actually occur now or are likely to occur in the future. Based on interviews with Revenue Canada officials in some of the Tax Services Offices we visited, we understand that examples of each type have been encountered. In any event, it is clear that the effort expended by Revenue Canada to ensure that dates of substantial completion are reasonable, items of expenditure are allowable, and fair market valuations are reasonable represents a significant administrative cost.

An evaluation of the New Housing Rebate program is needed

36.27 The recognition that the New Housing Rebate program involves potentially significant compliance and administration costs and that there are opportunities for tax planning that may affect the achievement of program

objectives suggests the need for an evaluation of the program. Other matters that will be dealt with later in the chapter point in the same direction. The kinds of questions arising from the findings of our audit that might be investigated in an evaluation of this program include the following:

- Are owner-builders able to obtain rebates for GST paid on categories of expenditure (“extras”) that other rebate claimants are not?
- Is the “clawback” operating effectively to deny the New Housing Rebate to those who acquire very expensive homes?
- Should the use of the fair market value concept be limited, as it was for the provisions affecting social housing in the 23 April proposed amendments?
- Are ineligible persons more likely able to obtain the New Housing Rebate by assigning it to builders, and are builders placing themselves at risk of possible collection action by Revenue Canada in respect of such rebates?
- How great are the compliance and administration costs associated with the program, and is it feasible to modify the program in order to reduce such costs?

36.28 Obviously, an evaluation of the New Housing Rebate program would address issues other than those suggested by the audit-related observations noted above. These would include such basic evaluation questions as:

- What has been the effect of the lower effective GST rate (that is, net of the New Housing Rebate) on the residential construction industry?
- Does the structure of the program (for example, the clawback threshold) provide equitable distribution of benefits, given regional variation in the level of new home prices? (Exhibit 36.3)

Exhibit 36.3

Regional Variation in New Home Prices

A comparison of average unit selling price of all newly constructed and unoccupied single detached and semi-detached dwellings

Selected Market Area	June 1989*	June 1995
Halifax	\$ 105,641	\$ 120,431
Charlottetown	\$ 109,700	\$ 118,518
Trois Rivières	\$ 70,416	\$ 75,101
Montreal	\$ 121,765	\$ 127,810
Toronto	\$ 320,992	\$ 331,874
North Bay	\$ 101,538	\$ 120,615
Regina	\$ 113,517	\$ 142,291
Edmonton	\$ 137,456	\$ 157,013
Vancouver	\$ 353,289	\$ 500,107

Source: Canada Mortgage and Housing Corporation

* 1989 was selected for comparison because that was the year in which the Technical Paper on the GST was published. The Technical Paper contained a table of median selling prices for the cities noted in this exhibit.

- Do purchasers who choose to assign their rebates to builders benefit from the program to the same extent as those who choose to obtain their rebates personally?

36.29 The Department of Finance, together with Revenue Canada, should perform an evaluation of the New Housing Rebate program.

Finance’s response: The Department of Finance continues to monitor the New Housing Rebate Program on an ongoing basis. However, the Department will consider the need for an evaluation in conjunction with other evaluation priorities.

Revenue Canada’s response: Revenue Canada will consider the need for an evaluation of the GST New Housing Rebate program in consultation with the Department of Finance as part of its ongoing evaluation planning activity.

Automated edit checks provide basic screening of claims

36.30 Claims processing and audit.

Applicants outside the Province of Quebec claim a New Housing Rebate by submitting a completed “New Housing Application for Rebate of Goods and Services Tax” form to Revenue Canada’s Summerside Taxation Centre (STC). Quebec residents must file their application with the Ministère du Revenu du Québec’s (MRQ) processing centres in Quebec City or Montreal. Our audit was confined to Revenue Canada’s areas of responsibility, so the discussion that follows does not deal with procedures performed by the MRQ. However, we understand that the system used by the MRQ is the same as that used by Revenue Canada.

36.31 Most of the processing steps up to and including the approval/payment of the rebate are performed at the Summerside Taxation Centre (see

Exhibit 36.4). Some claims require more extensive pre-approval/payment verification than the processing centres are equipped to handle, and are referred to one of Revenue Canada’s Tax Services Offices (TSO) for audit. Data are sketchy, but based on partial information for the year ended 31 March 1995, it appears that roughly 28 percent of claims pass the edit checks and are approved/paid after a cursory review of the documentation supporting the claim by the Summerside Taxation Centre. A further 54 percent of claims are approved/paid after a somewhat more extensive review by either the STC or Tax Services Office. The remaining 18 percent of claims are subject to an audit by the TSO and result in adjustment or disallowance.

36.32 At the Summerside Taxation Centre, applications are sorted by rebate type, such as owner-built and builder-built, and subjected to a preliminary review to determine whether all mandatory information has been provided. All rebate applications are sent for input into the data processing system; however, incomplete applications are flagged on the system so that approval will not be given until the application is satisfactorily completed. If necessary, the Centre contacts the applicant to obtain missing information and returns unsigned applications to the sender for signature. No data are available on the number of claims for which information to complete the claim or signature is requested.

36.33 At the time of data capture, claims are subject to a number of automated edit checks and selection criteria designed to identify any suspect claims. Claims identified in this manner are forwarded to the STC Review and Verification Unit or to the appropriate Tax Services Office for review and/or audit. In other words, approval/payment of claims

18 percent of claims are subject to an audit and result in adjustment or disallowance.

Edit checks look for calculation errors, claims in excess of allowable maximums, logical inconsistencies, and late-filed claims.

is not denied on the basis of automated edit checks alone, merely deferred. Claims failing the automated edit checks are examined further. However, claims that pass the automated edit checks are approved/processed for payment.

36.34 The automated edit checks look for duplicate claims by comparing the present application with records of other applications. This comparison is made using a number of common reference factors in order to increase the probability that a duplicate claim will be noticed. We reviewed some exception reports indicating items identified by the automated edit checks as potential duplicate claims or claims with other potential problems.

36.35 The automated edit checks also look for calculation errors, claims in excess of allowable maximums, logical

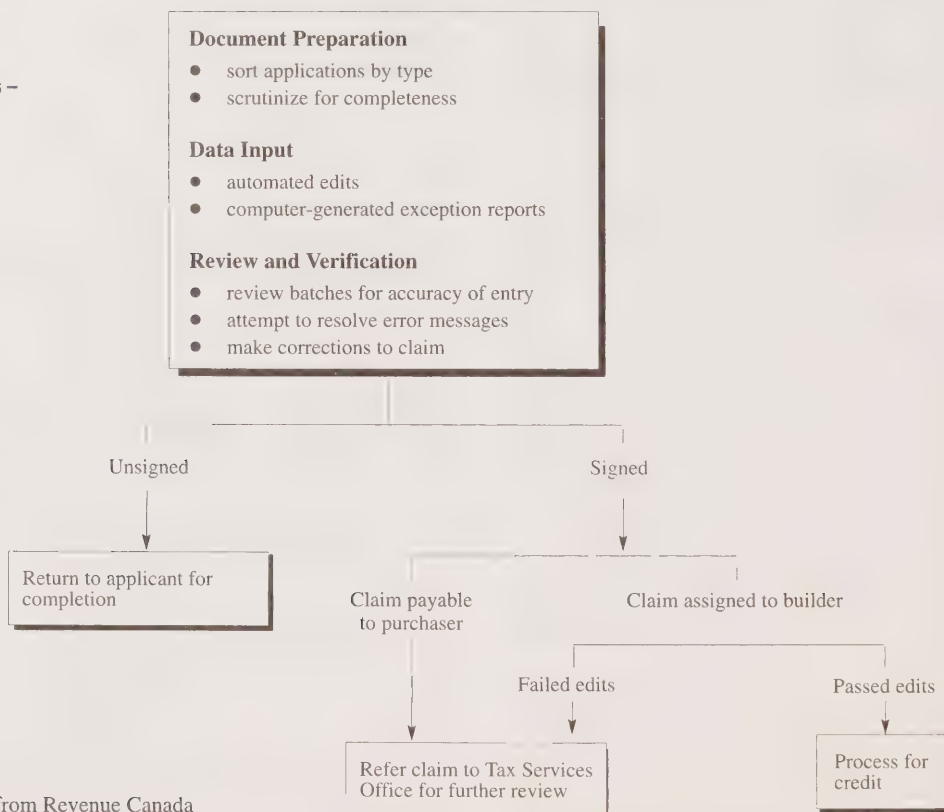
inconsistencies in information provided on claims, and claims that have been filed late. The selection criteria programmed into the automated system also flag claims that have a high risk of problems such as ineligible claimants, properties and items of expenditure. The system does not necessarily look for these specific problems but may simply select types of claims that are perceived to have a high risk of containing any of a number of kinds of problems. For example, any claims in which the rebate is to be paid to the purchaser rather than assigned to the builder are routinely flagged for further review.

Audit activity focusses on claims by “owner-builders”

36.36 We turn now to the processing of claims that fail the automated edit checks. Revenue Canada’s initial risk assessment

Exhibit 36.4

**Processing New Housing Rebates –
Summerside Taxation Centre**



Source: Based on data obtained from Revenue Canada

determined that New Housing Rebate claims assigned to the builder (estimated to be about two thirds of all claims) would be automatically approved if the application passed all the automated edit checks. Few builder-assigned rebates are highlighted as a result of the automated edit checks. Revenue Canada regards these claims to be of lower risk than rebates paid directly to the purchaser. This is because the Department provided builders with a bulletin on the completion of rebate applications. The builder submits claims for assigned rebates as part of the regular GST return and records the assignment along with any input tax credits as an offset to any GST payable. If the amount of the offsetting credits is sufficiently large to entitle the builder to a refund, the return could be subject to a “credit return review” and the builder could be selected for audit.

36.37 All other types of New Housing Rebate payments are paid directly to the purchaser/owner-builder (estimated to be about one third of all claims). Revenue Canada determined that these claims had a higher risk of error and should be subject to prepayment audit. (Unlike builder-assigned rebates, purchaser/owner-builder rebates would not normally be subject to an audit after payment. Thus there would be no further opportunity to detect and recover any amounts paid in error.) This decision was based, in part, on the high rate of errors discovered on the applications. One Tax Services Office we visited estimated that, on average, New Housing Rebate claims were reduced in amount by about 20 percent as a result of audit.

36.38 For the year ended 31 March 1996, 37 percent of the number (35,450 out of 95,390) and 28 percent of the value (\$85 million out of

\$303 million) of approved New Housing Rebate claims were filed by owner-builders. Many “owner-built” situations are similar to “builder-built” situations in all respects but one — the land and building are sold to the purchaser in separate transactions. In some provinces, this structure is used to reduce land transfer taxes. However, it has the side effect of causing Revenue Canada to classify the purchaser as an “owner-builder” for rebate purposes. Thus, this structure carries with it the added advantage of enabling the owner-builder to possibly hold open the date of “substantial completion” and to increase the base of GST-paid expenditures on which the New Housing Rebate is calculated, as discussed in an earlier part of this chapter.

36.39 In 1996 the Summerside Taxation Centre began a pilot project with one of the regions. In that region, all applicants for the New Housing Rebate for owner-built homes are required to submit all the original receipts, an information sheet, and a cost summary worksheet supporting all amounts recorded on the application as GST paid. The STC reviews all the receipts, and notes (on the electronic notepad) any errors and other comments before forwarding the information to the Tax Services Office for further audit. It is expected that this manner of processing will improve utilization of available staff resources as non-audit staff at the STC are used to perform duties that were previously conducted by auditors at the Tax Services Office. In addition, it is expected that this will result in a more consistent and uniform application of allowable expenses. However, no results data are yet available given that the pilot project was only recently started.

One Tax Services Office we visited estimated that, on average, New Housing Rebate claims were reduced in amount by about 20 percent as a result of audit.

A manner of processing now being pilot-tested promises to improve utilization of staff resources.

The Department does not wish to cause undue delays in making payments to registrants.

An understatement of the value of the consideration results in an understatement of the GST payable on the sale.

Prepayment audits and post-audits provide further opportunities to examine builders

36.40 Prepayment audit of credit returns. “Credit return” is the term used by Revenue Canada to indicate a GST return in which a refund is being claimed. Using a different automated system analogous to that used for New Housing Rebate claims, the Department subjects credit returns to a series of edit checks that focus mainly on one-time and cumulative dollar values of refunds claimed. Credit returns that are flagged by the system (which is operated by headquarters) may be audited before payment of the refund requested. Returns may also be flagged for tracking purposes according to monetary threshold criteria supplied by individual Tax Services Offices. Information on credit returns that are flagged in this manner is downloaded electronically to the TSO on a daily basis.

36.41 Once received at the Tax Services Office, the return information is screened by an audit manager. The audit manager decides whether to refer the return for an audit or approve payment without audit. The Department does not wish to cause undue delays in making payments to registrants as this could adversely affect registrants’ cash flow and increase interest payable by the Department (which begins 21 days after the return is filed). For those reasons, about 85 percent of credit returns are normally paid quickly. The Department feels it has an additional measure of protection in the case of registrants in a credit position because it could still select the registrant for a post-payment audit at any time within the next four years. Although we were told that builder-assigned New Housing Rebate payments could be examined through the audit of credit returns, we were unable to

obtain statistics on the extent to which this actually happens.

36.42 Post-audit. The term “post-audit” refers to an audit of a registrant’s past GST returns. During our visits to headquarters and district offices, managers outlined the sources of information used for selection of registrants for post-audit, such as leads from all sources, credit returns from the Audit Workload System, quarterly reports on builders, information contained in the Registrant Database and other databases such as business licences, building permits and income tax information. The nature and extent of registrant selection using one or more of the available tools is left up to the individual Tax Services Offices. Several TSOs we visited used commercial software tools to review the registrant database for trends and potential audit leads. The post-audit selection system (PASel) is a computerized tool that helps to identify high-risk registrants. The Department is presently working on a second-generation PASel system that will improve upon the original version.

One Tax Services Office we visited focussed on audits of large builders

36.43 One of the larger Tax Services Offices we visited chose to audit all large builder/developers in its area (including the New Housing Rebates that had been assigned to them). There were three main areas in which it found non-compliance. The first dealt with failure to properly account for assigned rebates in determining the value of consideration received for the property sold. An understatement of the value of the consideration results in an understatement of the GST payable on the sale. This was a contentious issue between builders and Revenue Canada, as builders felt that the Department had failed to give adequate guidance on how to perform the proper

calculation. While the issue of what constitutes the correct method of determination now seems to be resolved, it did generate quite a few appeals in past years. It is presumed that many builders used an incorrect method in the past and that post-audits of these builders would yield a substantial amount of GST revenue. See Exhibit 36.5 for examples of the correct method and one incorrect method.

36.44 Other areas of non-compliance included failure by the builder to assess GST under the “self-supply” rules (for example, where units intended for sale as condominiums are instead rented out) and

failure to remit to Revenue Canada all GST collected from home purchasers.

36.45 Revenue Canada should assess whether, on a national basis, there is sufficient audit coverage of builders. In particular, the Department should consider whether enough work is being done to verify New Housing Rebate payments that have been assigned to builders.

Revenue Canada’s response: The Department concurs with this recommendation and, as noted by the Auditor General, one of our larger Tax Services Offices chose to audit all large builders/developers in its area. If results of

Correct method:	
Amount paid by purchaser	\$150,000
Value of consideration ($\$150,000/1.0448^1$)	\$143,568
GST liability (7 percent of \$143,568)	\$10,050
GST New Housing Rebate (36 percent of \$10,050)	\$3,618
Incorrect method:	
Amount paid by purchaser	\$150,000
Value of consideration ($\$150,000/1.07^2$)	\$140,187
GST liability (7 percent of 140,187)	\$9,813
GST New Housing Rebate (36 percent of \$9,813)	\$3,533
Effect of using the incorrect method:	
A builder who sells a new house and accepts an assignment of the GST New Housing Rebate remits to Revenue Canada the difference between the amount of the GST liability and the amount of the rebate. Using the correct method, the required remittance is \$6,432 (\$10,050 minus \$3,618). Using the incorrect method, the builder would remit \$6,280 (\$9,813 minus \$3,533). The difference of \$152 (\$6432 minus \$6,280) represents a loss of tax revenue to the federal government.	

¹ The GST rate is 7 percent. The GST New Housing Rebate is 36 percent of the GST paid. Therefore, the effective GST rate in situations where the GST New Housing Rebate is paid is 4.48 percent (64 percent (100 – 36) of 7 percent). The effective GST rate can be expressed in decimal format as .0448.

Since the selling price includes GST, in order to find the value of the consideration (the basis upon which GST is calculated), it is necessary to “back out” the amount of GST embedded in the selling price. This is done by dividing the selling price by a factor of 1 plus the effective GST rate (1 + .0448).

² By failing to properly take into account the GST New Housing Rebate, an incorrect factor is calculated. See footnote 1 to see how the factor should have been calculated.

Exhibit 36.5

Calculation of the GST Liability and the New Housing Rebate where the Rebate Has Been Assigned to the Builder

Audits of builders have revealed that errors often occur in the calculation of the GST liability and the New Housing Rebate where the rebate has been assigned to the builder and the purchaser has paid a “GST included” price. The following examples illustrate the correct method of calculation and another commonly used — and incorrect — method.

A person might purchase a house, claim a GST New Housing Rebate, and then not use the house as a personal residence.

this project warrant, the Department will undertake a national project within the next fiscal year.

Builders are at risk if purchasers are not eligible for the New Housing Rebate

36.46 A final difficulty pertaining to the New Housing Rebate involves establishing the intention of the claimant to occupy the residential complex as a personal residence. The concern here is that a person might purchase a house, claim a GST New Housing Rebate, and then not use the house as a personal residence but instead sell it exempt from GST as a used home, or rent it out. Builders may find themselves at risk where they have accepted assignment of the New Housing Rebate as part of the purchase consideration. If Revenue Canada were to discover through audit that the claimant had not met the occupancy conditions for receipt of the rebate, it might attempt to recover it from the builder. Some builders, recognizing this risk, have instituted a practice of requiring purchasers to sign a declaration affirming their eligibility for receipt of the rebate.

36.47 We understand that the New Housing Rebate Program allows for the assignment of rebates in order to ease the burden of financing on purchasers. This implies that Revenue Canada would wish to remove any unnecessary impediments to builders' acceptance of rebate assignments. If builders are made aware of their “due diligence” requirements, and if they comply with them, they should be able to accept rebate assignments without exposing themselves to undue risk.

36.48 Revenue Canada should provide guidance to builders on the Department's expected minimum standards for due diligence when determining the eligibility for the New

Housing Rebate of purchasers from whom they accept assignment of the rebate.

Revenue Canada's response: The Department works through industry associations like the Canadian Home Builders Association to improve the flow of information and the understanding of eligibility of purchasers for the New Housing Rebate. At the beginning of the implementation of the New Housing Rebate program, a bulletin was provided to all builders on our database that included information on standards for due diligence. As well, field auditors were provided guidance on this issue in a directive. Revenue Canada will continue to provide reminders to the building community.

Little reliable information is available on a timely basis

36.49 **Information for management.** Information to manage the New Housing Rebate program is derived from the GST automated system. Information is captured at the time of data entry at the Summerside Taxation Centre, additional information is added at the Tax Services Office if the claim is subject to further audit, and final information is recorded at the time of payment.

36.50 During our audit we requested various statistics relating to the New Housing Rebate program, including the total amount of rebates paid by type of rebate, total number of claims processed, number of claims that were subject only to automated processing, and number of claims that were subject to further manual processing and/or audit by Summerside Taxation Centre or the various Tax Services Offices. Some of this information is not readily available for the full period covered by our audit. The report that had previously provided this information was discontinued as of 31 March 1995 because it was discovered that systems problems

The Department discovered that systems problems were compromising the accuracy and reliability of the reported results.

were compromising the accuracy and reliability of the reported results. The Department is currently writing software that will enable it to gather the information, but it is not known when it will be ready.

36.51 We also requested information on the number of audits performed by type of claim, the types of errors encountered, and the tax changes that resulted from those audits. While none of this information is routinely available, some of it can be obtained on request, although a request takes about 90 days to process. Some information, such as the number of claims that are not audited despite having been flagged by the automated edit checks or selection criteria, and the types of errors found, is not available at all.

36.52 Revenue Canada should ensure that reliable and appropriate information with which to manage the New Housing Rebate program is available on a timely basis.

Revenue Canada's response: Some changes to our processing and reporting systems were made during the course of this audit. Also, the Department has completed writing the software referred to by the Auditor General and is now in a position to gather the required reliable information on a timely basis.

Self-Supply

36.53 A specific enforcement problem: self-supply of new multiple-unit residential complexes. The general rule is that sales of new housing are taxable and sales of “used” housing are exempt from tax. Rentals of housing (except short-term accommodation) are exempt from tax. To ensure that GST is paid on housing that is rented by the builder of the property, since no sale has taken place, certain provisions of the *Excise Tax Act* deem a sale to have

occurred at the fair market value. The provisions require the builder to remit seven percent GST on this deemed sale at the time when the complex is first occupied, based on its fair market value at that time. This is referred to as “self-supply”.

36.54 These self-supply rules apply to all residential complexes. For multiple-unit residential complexes, the builder must remit seven percent GST on the fair market value of the entire building at the time the first unit is rented. In some instances, builders complete a complex intending to sell the individual units as registered condominiums, but in an attempt to increase cash flow or to wait until the market improves, instead rent all or some of the units and fail to report on the fair market value of the rental portion of the complex. Renting out the units will also disqualify them from the New Housing Rebate as they will now be classified as “used” units.

36.55 The assessment and remittance of the GST on the fair market value of the complex is dependent on the builder's voluntary compliance with the self-supply rules. A loss of GST revenue arises when the builder fails to self-assess and remit the GST payable when the self-supply is deemed to occur. This is, in fact, a relatively frequent occurrence. A contributing factor may be that some of the builders “caught” by the self-supply rules are not GST registrants. One can expect a higher degree of knowledge about the GST among registrants than non-registrants.

36.56 One of the ways Revenue Canada can enforce timely compliance with the self-supply rules for rental complexes is to develop specific detection and enforcement techniques. Without a specific audit project, many of these complexes can remain undetected for

For multiple-unit residential complexes, the builder must remit GST on the fair market value of the entire building at the time the first unit is rented.

A loss of revenue arises when the builder fails to self-assess and remit the GST payable.

About 46 cases have been assessed as a result of the project, generating assessments of approximately \$3.9 million.

considerable time, and circumstances could arise where collectability of the assessment could be impaired. This is true despite the fact that there is typically an extensive trail of documents that can be used to identify such complexes.

An audit project was directed at “self-supply” issues

36.57 One Tax Services Office has set up a project that reviews new building permits, occupancy permits and other related documentation to identify multiple-unit construction in the district. The auditor also tracks projects that have been identified as condominium units to ensure that the units are, in fact, sold on an individual basis and not rented. In the past three years, about 46 cases have been assessed as a result of the project, generating assessments of approximately \$3.9 million from builders who had not self-assessed prior to audit. Currently, the auditors have undertaken to contact builders prior to completion of a project to encourage voluntary compliance with the self-supply rules. Once a new construction project is identified, an auditor contacts the builder of the project and arranges a meeting to explain the compliance requirements of the self-supply rules and provide the builder with the necessary guides and other information.

36.58 During our audit, we found that the level and nature of enforcement activities to ensure compliance with the self-supply rules varied among the Tax Services Offices visited. While some Offices have attempted to ensure compliance with the self-supply rules during regular audits, where applicable, and review building permits and title transfer databases when time and personnel resources are available, they do not appear to use these detection and

enforcement techniques in a systematic and thorough way.

36.59 Revenue Canada should consider the merits of having a national audit project to address the problem of non-compliance with the self-supply rules applicable to builders of multiple-unit residential complexes.

Revenue Canada’s response: The Department established the project referred to in the chapter to assist in determining the compliance risk associated with self-supply rules to builders of multiple-unit rental buildings. The results of this project are being assessed. Analysis will be completed by the end of next fiscal year. If results of this project warrant, the Department will undertake a national project.

Initial concern over potential loophole is abating

36.60 “House hoppers”. The *Excise Tax Act* contains various provisions that are meant to deal with specific situations. This section deals with one such provision and the concern that it may be open to abuse.

36.61 To set the stage, consider a situation in which an individual who is in no way in the business of constructing or selling houses constructs a house, using much of his own labour, for his personal occupancy as a residence. The individual will pay GST on the materials and other inputs purchased from a GST registrant in order to undertake the construction. When the individual begins to occupy the house, there will be no further GST payable. This should result in a lower amount of GST liability than would have been incurred had the individual purchased an identical property from a builder. This is because the individual would not have paid GST on things such as the builder’s profit, the value of services performed by the individual and certain costs that are

GST-exempt to the individual (for example, interest charges, insurance and property taxes).

36.62 Now consider a situation in which an individual who is in the business of constructing or selling houses constructs a house for his personal occupancy as a residence. In the absence of any special rules, this individual, because he would be a “builder” as defined in the *Excise Tax Act*, would be deemed to have made a “self-supply” and would have to pay GST on the fair market

value of the property. To avoid this result and ensure that the “builder” is not treated more harshly than the ordinary individual, the *Excise Tax Act* provides a special rule that excludes an individual from being a “builder” in this situation and therefore from the self-supply rules.

36.63 Revenue Canada has encountered cases where builders, under the guise of having constructed houses for their personal occupancy, have attempted to avoid the GST that would be imposed under the self-supply rules and then sell

		Builder-built Home	House Hopper
		Selling Price (excluding GST) of \$200,000	Fair Market Value of \$200,000
	GST paid on inputs	Cost/Profit	Cost
Land	\$ 4,200	\$ 60,000	\$ 60,000
Building Materials	4,200	60,000	\$ 60,000
Labour – employees		30,000	“self-contributed”
Subcontractors	2,100	30,000	\$ 30,000
Interest charges, Insurance and Property taxes		10,000	
Profit		10,000	GST-exempt “notional”
Selling price		\$ 200,000	
GST paid on inputs	\$ 10,500		
GST Position:			
GST payable (7% x \$200,000)		\$ 14,000	\$ N/A
New Housing Rebate (36% x \$14,000)		(5,040)	
GST paid to suppliers (remitted to RC)		10,500	10,500
New Housing Rebate (36% x \$10,500)			(3,780)
Less: Input tax credits claimed by builder for GST paid		(10,500)	N/A
Net GST revenue to government		\$ 8,960	\$ 6,720
Net loss of GST revenue (\$8,960–\$6,720)			\$ 2,240*

N/A – not applicable

*Note: Net loss of GST revenue would be even greater if land were “used” and purchased GST-exempt, if subcontractors operated in the underground economy, or if the house hopper contributed more labour than the 50 percent proportion assumed in this example.

Exhibit 36.6

**Builder-built Home vs. House
Hopper**

Net GST Position — Similar
Homes

The “house hopper” stands to save a portion of the GST and may qualify for the New Housing Rebate.

the houses as used properties, which are GST-exempt. Typically in these situations, the builders have constructed and sold a number of houses in a relatively short time, trying to side-step the self-supply rules each time. This pattern has caused the Department to coin the term “house hopper” to describe the individual involved.

36.64 If successful, the house hopper not only stands to save a portion of the GST (see Exhibit 36.6), but also may qualify for the New Housing Rebate and thus obtain a partial refund of the GST he or she paid on materials and services used in construction of the house. The house hopper may also fail to declare the profits from the sale of the houses thus evading income taxes.

36.65 When Revenue Canada notices a house hopper, it issues an assessment to recover the GST avoided and any unentitled New Housing Rebate. When the first such assessment to be challenged in the courts was overturned, the Department became concerned that a loophole had been discovered and that it would be unable to take effective action against house hoppers’ activities. However, three subsequent court cases involving house hoppers have been found in Revenue Canada’s favour, causing the initial concern to abate somewhat.

36.66 Nevertheless, both Revenue Canada and the Department of Finance feel that the situation needs monitoring. The fact that the result in each of the four cases has been reasoned on somewhat different grounds suggests that there may be some ambiguity in the wording of the relevant provisions. For example, differences between the provision relating to payment of the GST and the provision establishing entitlement to the New Housing Rebate in the terms used to

describe one particular concept have led to mixed findings within the same case.

36.67 All of the court cases to date have been heard under the Tax Court of Canada’s informal procedure and therefore do not have precedential value. A decision under the Tax Court’s general procedure or a decision of a higher court could provide greater certainty about how the law should be interpreted.

36.68 **Revenue Canada and the Department of Finance should continue to monitor evolving jurisprudence as it relates to the issue of “house hoppers” in order to determine whether there is a technical problem with the wording of the *Excise Tax Act* that would need to be remedied by way of legislative amendment.**

Finance’s response: The Department, along with Revenue Canada, will continue to monitor this issue, and evaluate the desirability of legislative amendments in light of future court decisions.

Revenue Canada’s response: Given that the Department has been successful in three out of four court challenges, it is not clear whether a legislative amendment is required on this issue. However, the Department will continue to closely monitor non-compliance in this area and will work with the Department of Finance to address this concern.

The voluntary disclosure policy provides little encouragement for non-compliant builders to come forward

36.69 Given that the amount of GST payable on the self-supply of a large multiple-unit residential complex may be quite substantial, it is reasonable to ask what incentives are in place for non-compliant builders to come forward and properly settle their liabilities with Revenue Canada. Part of Revenue Canada’s efforts to promote voluntary

The fact that the result in each of the four cases has been reasoned on somewhat different grounds suggests that there may be some ambiguity in the wording of the relevant provisions.

compliance (not specific to residential real property transactions) consisted of the introduction of a policy of voluntary disclosure to encourage people to report previously unreported amounts of GST payable. To be considered voluntary, a person must initiate the disclosure before Revenue Canada has undertaken an audit or any other enforcement measure. The perceived benefit of this policy is that Revenue Canada will not assess civil penalties for gross negligence or institute a criminal prosecution and, in certain circumstances, may exercise discretion and waive the usual six percent penalty.

36.70 In practice, the six percent penalty is not waived; a voluntary disclosure brings full interest and penalties and the total amount payable is likely to be the same as if the transaction were found during an audit. It is believed that people who attempt to comply with the law but who have erred find little comfort when they come forward in good faith. We are aware that some tax professionals are advising clients not to make a voluntary disclosure when they discover that they have made innocent errors but instead to “stop the clock” by making the appropriate remittances and to wait for an audit.

36.71 During our audit we requested various statistics on GST voluntary disclosures. However, the number of voluntary disclosures is not available since there is no recording system in place in most Tax Services Offices to track them.

36.72 The current policy on voluntary disclosure does not appear to be producing the intended results. It discourages disclosure by even those registrants who have sincerely tried to comply with complicated legislative provisions yet have failed, as agents of the Crown, to collect the tax from others.

36.73 Revenue Canada, in consultation with the Department of Finance, should evaluate its voluntary disclosure policy to determine whether it is achieving its desired effect of encouraging compliance.

Revenue Canada’s response: The voluntary disclosure policy is currently under review by the Department for the purpose of developing a completely harmonized disclosure policy for all business lines.

Conclusion

36.74 The administration of the GST as it applies to the New Housing Rebate and residential real property transactions involving “self-supply” presents Revenue Canada with significant challenges. Recently proposed technical amendments to the *Excise Tax Act* address a number of problems; however, an evaluation of the New Housing Rebate program would likely provide valuable information to policy makers on whether the remaining difficulties with the program pose a significant threat to its ability to achieve its objectives.

36.75 The systems and procedures for processing and auditing New Housing Rebate claims are designed to focus on claims that are perceived to present a high risk of non-compliance. However, the absence of reliable and timely management information makes it difficult to assess how effective these systems and procedures are in practice. Further, Revenue Canada has given limited attention to audits of builders other than “owner-builders”.

36.76 Available data on a special project aimed at non-compliance with the self-supply rules applicable to builders of multiple-unit residential complexes indicate good success, and suggest that

A voluntary disclosure brings full interest and penalties and the total amount payable is likely to be the same as if the transaction were found during an audit.

An evaluation of the New Housing Rebate program would likely provide valuable information to policy makers.

there may be value in expanding the project.

36.77 Revenue Canada and the Department of Finance need to continue monitoring evolving jurisprudence as it relates to the issue of “house hoppers” in order to determine whether there is a

technical problem with the wording of the legislation that would need to be remedied by way of amendment.

36.78 Revenue Canada, in consultation with the Department of Finance, needs to re-examine its voluntary disclosure policy.



About the Audit

Objective

The objective of our audit was to examine the application of the GST to residential real property transactions in order to identify areas where there is significant risk of non-compliance or of difficulties in achieving program objectives. We focussed on two such areas: administration of the GST New Housing Rebate and of the self-supply rules applicable to multiple-unit residential complexes. We also examined how Revenue Canada and the Department of Finance respond to this risk.

Scope

Our examination was conducted in Revenue Canada headquarters and in selected Tax Services Offices. It consisted of interviews and the review of audit and appeals files and other relevant documents.

Criteria

There should be procedures in place to identify areas of non-compliance and pursue an appropriate strategy for dealing with them. Appropriate strategies may include some or all of the following:

- providing clear, accurate and timely guidance to taxpayers/registrants explaining how they are to comply with the law;
- designing and implementing effective enforcement programs aimed at correcting and deterring non-compliance; and
- working with the Department of Finance to introduce technical amendments to the legislation in a timely manner.

There should be procedures to measure and report program effectiveness. Those procedures should reflect the state of the art and be cost-justified.

Reliable and appropriate information should be available on a timely basis to enable management to administer tax measures.

Audit Team

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Chapter 37

Revenue Canada

Enforcing the *Income Tax Act* for
Large Corporations

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants.

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Revenue Canada

Enforcing the *Income Tax Act* for Large Corporations

Main Points

37.1 Revenue Canada's large file program provides a co-ordinated approach to auditing the tax returns of the largest and most complex corporations. The approximately 6,000 corporations within the program pay about 25 percent of total corporate tax revenue, or \$4 billion annually.

37.2 About 300 people deliver the program. Most are auditors located in various Tax Services Offices across the country. Revenue Canada reported that its audit efforts from the program in 1994–95 resulted in \$850 million in additional current federal impact and \$459 million in additional future federal impact.

37.3 The primary objective of Revenue Canada's auditors is to ensure compliance with the laws. Auditors face many challenges in doing their work, including the complexity and changing nature of the legislation, the use of administrative policies to deal with gaps in the legislation and the increasing complexity of business in a global economy.

37.4 In an effort to address some of these challenges and to improve relations with taxpayers, the Minister announced on 6 March 1995 a new approach to auditing large files. The approach is based on a co-operative, open and transparent relationship between the taxpayer and Revenue Canada. It is too early to tell how successful this approach may be, but improving the relationship between Revenue Canada and taxpayers should benefit both parties.

37.5 Selecting the right issues to audit is a primary key to success. Some improvements have been made but more needs to be done to ensure that auditors select those issues that represent the highest risk of non-compliance and to assure management that this is being done.

37.6 Revenue Canada has been auditing returns several years after they are filed; this has caused problems for taxpayers and for the Department's auditors. An initiative has been in place since 1994 to audit returns sooner, and established targets have been largely met. We support this initiative, as we see the benefits for both taxpayers and Revenue Canada. The costs of achieving these targets, in terms of possible missed reassessments, is not known.

37.7 To provide a more complete picture, the published program results need to be supplemented with more information on the actual amounts billed or refunded to taxpayers and with information on subsequent appeals. Revenue Canada does not yet adequately measure the effectiveness of the large file program in meeting its primary objective of enhancing compliance with the tax laws.

37.8 A number of human resource issues — such as gaps between the resources allocated and those used, and difficulties in staffing positions — are creating barriers to achieving better results from the program. As well, there is a need for an environment that fosters learning and continuous improvement in order to encourage the achievement of high-quality results.

Introduction

Program background

37.9 Canadian taxpayers are responsible for self-assessing their tax liabilities. Revenue Canada uses various techniques, including audit, to help them do this correctly. The Department's Verification, Enforcement and Compliance Research Branch is responsible for the audit function. Its primary objective is to enhance compliance with the laws administered by the Department.

37.10 Revenue Canada has several programs for enforcing the *Income Tax Act*. One of these, the large file program, provides Revenue Canada with a co-ordinated approach to auditing the tax returns of the largest and most complex corporations. Because of size, diversification, geographical dispersion, technical complexity and economic significance, audits of these corporations are carried out from an industry-wide, national and conglomerate perspective, rather than with the more usual corporation-by-corporation focus.

37.11 The audit universe identified by Revenue Canada for the large file program includes approximately 200 primary corporations and 6,000 other corporations controlled by or related to them. Every tax return of a primary corporation is audited to some extent. Audits of controlled corporations are done at the discretion of the large file case manager.

37.12 About 300 people deliver the program. Most are auditors located in various Tax Services Offices across the country. Details are provided in Exhibit 37.1.

37.13 We audited Revenue Canada's large file program at headquarters and

selected Tax Services Offices to see if there are opportunities for improvement. Our audit objectives, scope and criteria are presented in more detail at the end of the chapter in the section **About the Audit**. For the most part, we reviewed audits that covered the 1987 to 1992 taxation years.

Income taxes paid by large corporations

37.14 Exhibit 37.2 sets out corporate income tax revenue reported in the Public Accounts of Canada for years ending 31 March 1988 to 1996. This revenue is reported on a cash basis in accordance with the government's stated accounting policies. In other words, this revenue represents the cash received during each fiscal year from corporate income tax and related interest and penalties, less cash refunds paid out.

37.15 Exhibit 37.3 sets out the corporate income taxes assessed for all the corporations in the large file program for the years 1988 to 1994. While the numbers in the two exhibits are not directly comparable (one shows cash collected and the other shows tax assessed by taxation year), it is clear that the corporations included in this program are contributing significant amounts to total corporate tax revenue.

Exhibit 37.1

Field Resources Allocated to the Large File Program in 1995–96

	Number of Full-Time Equivalents (FTE)	Number of Tax Services Offices
Atlantic Region	11	3
Quebec Region	99	3
Southern Ontario Region	130	9
Northern Ontario Region	3	2
Prairie Region	60	5
Pacific Region	14	2
Total	317	24

Source: Revenue Canada

37.16 Exhibit 37.3 shows that although there are relatively few corporations included in the large file program, they pay hundreds of millions of dollars in taxes. This gives them a legitimate incentive to seek legal arrangements to reduce that tax burden. Sometimes these arrangements subvert the purpose of taxation provisions. When this happens, Revenue Canada seeks to challenge the arrangement. Chapter 11 of our May 1996 Report discusses Revenue Canada's program for combatting income tax avoidance.

Observations and Recommendations

Revenue Canada's Auditors Face Many Challenges

Legislation is complex and constantly changing

37.17 The primary objective for Revenue Canada's auditors is to ensure that taxpayers comply with the laws. For the corporations in the large file program, this is accomplished by reviewing their

Exhibit 37.2

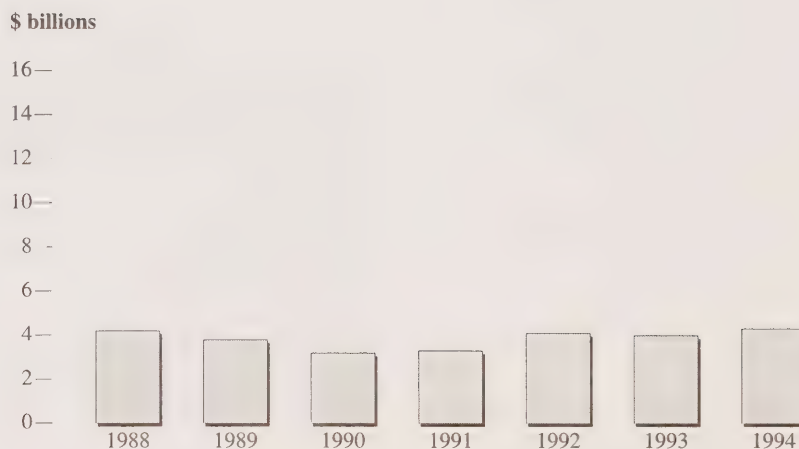
Corporate Income Tax Revenues



Source: Public Accounts of Canada

Exhibit 37.3

Total Federal Taxes Assessed for Corporations in the Large File Program



Source: Revenue Canada

tax returns and supporting documentation, and reassessing issues where the Department disagrees with the taxpayer's self-assessment. Most of the reassessments we reviewed dealt with questions on which the law can be interpreted in more than one way.

37.18 One of the many challenges faced by Revenue Canada's auditors, and by taxpayers, is the complex and changing nature of tax legislation. The Department of Finance seeks to have legislation that meets its policy requirements while taking into account the differing economic circumstances of corporations. The result is often complexity. This is particularly true for many large corporations. The rules dealing with foreign accrual property income and corporate reorganizations are but two examples.

37.19 Complexity often makes it difficult for taxpayers to comply with the legislation and for Revenue Canada to verify that compliance. Complexity also provides tax-planning opportunities. Taxpayers can use the complex rules to their advantage, sometimes going beyond what the law intends. Revenue Canada's auditors need to understand the legislation and its intent in order to be able to detect and successfully challenge non-compliance. The Department has training programs in place designed to achieve this.

37.20 The *Income Tax Act* is also subject to frequent amendment. Annual budgets usually present some tax changes, and technical changes are made from time to time to deal with problem areas, some of which are identified by auditors. Again, auditors need to be aware of the changes and the dates on which they become applicable. Keeping up-to-date with changes in tax legislation is an ongoing challenge for taxpayers, tax professionals and Revenue Canada's auditors.

Use of administrative policies to deal with legislative gaps

37.21 It is well recognized that it is virtually impossible to write tax legislation to cover every type of situation applying to taxpayers. Revenue Canada uses administrative policies to deal with gaps in the legislation. These administrative policies seek to capture the intent of the legislation for transactions that are not specifically provided for in the legislation. It should be noted that although these administrative policies do not have the force of law, they are important for the smooth functioning of the system.

37.22 In recent years, financial markets have devised numerous instruments that take advantage of various tax provisions, sometimes in unintended ways. Two examples that were discussed in Chapter 11 of our May 1996 Report are shown in Exhibit 37.4. Sometimes Revenue Canada is faced with a situation that is not specifically covered by the legislation, although the intent of tax policy is clear. In our view, administrative policies are useful to deal with such circumstances. However, if these administrative policies are not legislated in a timely manner they may be challenged, particularly when they are restrictive, and may be overturned in the courts. This would have a negative impact on the tax base.

37.23 One of the administrative policies that we encountered deals with the utilization of losses within a corporate group. The document *Explanatory Notes to Draft Legislation and Regulations Relating to Income Tax Reform*, issued by the Minister of Finance in June 1988, addresses the issue. The notes indicate that the transfer of income or deductions between related corporations, which is accomplished using transactions that are legally effective and comply with any

Complexity often makes it difficult for taxpayers to comply with the legislation and for Revenue Canada to verify that compliance.

Revenue Canada has developed an "in-house" loss utilization policy.

applicable provisions of the *Income Tax Act*, would not usually result in a misuse of the provisions of the Act or an abuse of the Act read as a whole, for purposes of applying the general anti-avoidance rule. This is the basis on which Revenue Canada has developed its “in-house” loss utilization policy.

37.24 In effect, the administrative policy allows related corporations resident in Canada to transfer losses within the corporate group, with certain restrictions, and to pay tax on the profits of the group rather than the profits of each corporation. Exhibit 37.5 sets out an example of how this scenario has worked.

37.25 The administrative policy is based on the economic concept that two corporate groups should not be discriminated against for tax purposes,

because of the legal structure that each chooses. Under our current laws, if Company A chooses to organize itself in divisions, then the losses in one division will be offset against the profits in another and tax will be paid only on the net profit of the company. However, if Company B chooses to organize itself as several corporations, the current laws require the profitable corporations to pay tax without regard to any losses incurred by other corporations in the group.

37.26 We have two concerns. First, although the steps a company follows to accomplish a loss consolidation using Revenue Canada’s administrative policy must be legally effective and comply with the *Income Tax Act*, the Act contains no comprehensive loss-consolidation regime. Revenue Canada’s administrative policy is based on explanatory notes provided by

Exhibit 37.4

Examples of Financial Market Instruments That Take Advantage of Tax Provisions

Weak Currency Borrowing

A Canadian corporation borrows in a weak currency with a high interest rate. It immediately converts the proceeds into Canadian dollars and enters into a forward contract to sell Canadian dollars and buy the weak currency at the debt’s due date. The corporation ordinarily does not conduct business in the weak currency.

The corporation effectively obtains an interest deduction at a rate higher than the Canadian nominal rate and, through the forward contracts, it locks in a gain at the debt’s due date. The corporation maintains that the locked-in gain is a capital gain.

The corporation’s cost of borrowing can be reduced by as much as 200 basis points, and if it has unused capital losses to offset the capital gain, the cost of borrowing can be reduced by a further 150 basis points.

Premium Priced Debt

A Canadian corporation wishes to raise \$100 and its current credit rating will allow it to borrow at 10 percent. Instead of borrowing \$100 at 10 percent, it issues a five-year debenture for \$100 at a \$2 premium but agrees to pay interest at 10.4 percent.

The creditor recovers the \$2 premium through the increased rate of interest. The corporation maintains that the premium it received is not taxable, and it deducts the 10.4 percent interest it pays.

In substance, the premium is offset by higher interest payments over the term of the debenture so that the corporation pays the same 10 percent rate of interest as it would on a conventional borrowing. However, because the premium is not reported as income and the excess interest is fully deductible, the borrower achieves a lower cost of borrowing at the expense of the Canadian tax system.

On a borrowing of \$100 million at a 2 percent premium, the result would be a \$2 million tax-free receipt to the borrower and a \$1 million tax cost to the government.

the Department of Finance. As such, it does not provide taxpayers with the same certainty as legislation. Our second concern is that one of the schemes we saw involved over 30 individual transactions to accomplish the loss consolidation. We question why taxpayers should have to go to such lengths if it is Parliament's intent that they be allowed to pay tax only on the net profits of the group. In 1985 the Minister of Finance proposed a corporate loss transfer system involving simple elections. Legislation was never enacted to implement this system and instead we now have this administrative policy. As well, some corporations are not able to carry out the various transactions required to achieve a loss consolidation, due to regulatory or other restrictions.

37.27 Complex structurings to achieve a loss consolidation present a real challenge to Revenue Canada's auditors. They have to first detect and understand the transactions and then determine if they are consistent with the administrative policy and the spirit of the Act in order to decide whether a reassessment should and can be raised.

37.28 We also have concerns about an administrative policy on interest deductibility. The *Income Tax Act* permits a deduction for a reasonable amount of interest paid or payable in the year when the borrowed money was used to earn income from a business or property. The Department of Finance's approach to interest deductibility has been uncertain for some time. Draft legislation tabled in December 1991 was primarily designed to restore a Revenue Canada administrative policy on the deductibility of certain interest that had been overturned in the courts.

37.29 To date, actual legislation has not been introduced and is not expected in the

near future. Revenue Canada continues to apply its administrative policy but, because of the court decision and some aspects of the draft legislation, there is a sense of instability. In 1992 we noted that the Department of Finance had announced it was reviewing the subject of interest deductibility and we encouraged it to complete the review. We understand that the review has not yet been completed and that the Department of Finance supports Revenue Canada's administrative policy. In this case, it is unclear why the administrative policy has not been legislated.

37.30 Intercompany interest charges are also one of the tools that make many of the previously discussed loss consolidation schemes work. We observed a case of a taxpayer using intercompany borrowings to create losses in a profitable subsidiary. Those losses were then carried back to previous years, and taxes previously paid were refunded. The scheme is set out in Exhibit 37.6. Again, we note that such schemes present Revenue Canada's auditors with real challenges to both detect and investigate them for possible reassessment.

37.31 Revenue Canada should continue to consult with the Department of Finance with a view to improving the process so that legislative changes to reflect accepted administrative policies can be recommended to Parliament sooner.

Department's response: Revenue Canada has taken steps to improve the consultation process with the Department of Finance through the establishment of a discrete group whose primary responsibility is to ensure that required legislative changes are communicated promptly to the Department of Finance. In addition, senior management from both departments meet weekly to discuss issues

The Department of Finance's approach to interest deductibility has been uncertain for some time.

Exhibit 37.5

Example of Loss Consolidation

The objectives of the following transactions are:

- to allow Subsidiary B to reduce its future taxes by using the tax losses incurred by Subsidiary A, a related company.
- to allow Subsidiary A to obtain a refund of the cash taxes paid by Subsidiary B in prior taxation years.

Facts

1. Subsidiary A is a public company with large tax losses carried forward. Parent Company owns 75 percent of the shares of Subsidiary A.
2. Subco A1 is a wholly owned subsidiary of Subsidiary A. It was incorporated for the purposes of this transaction.
3. Subsidiary B is also a public company whose only assets are its investments in Subco B1 and Subco B2. Parent Company owns 67 percent of the shares of Subsidiary B.
4. Subco B1 is a wholly owned subsidiary of Subsidiary B. It was incorporated for the purposes of this transaction.
5. Subco B2 is a wholly owned subsidiary of Subsidiary B. Its only asset is its investment in Subco B3.
6. Subco B3 is a wholly owned subsidiary of Subco B2. It is profitable in a business unrelated to that of Subsidiary A and has paid taxes of approximately \$100 million in the last three taxation years.

Step 1:

Subsidiary A sells some of its investments in companies that it controls to Subco A1 in exchange for an interest-bearing note. Since Subsidiary A has losses carried forward it pays no tax on the interest income it receives from Subco A1. The interest expense incurred by Subco A1 creates large tax losses.

Step 2:

Subco B3 sells all of its operating assets at their tax cost to Subco B1 in exchange for preferred shares. The shares are then redeemed. Subco B3 is now a shell company that has paid taxes in the past.

Step 3:

Subco A1 sells all of its investments at fair market value back to Subsidiary A. Subco A1 is left with a note payable to Subsidiary A, a large deficit and its losses carried forward for tax purposes of approximately \$60 million.

Step 4:

Subsidiary B transfers its common shares in Subco B2 to Subsidiary A in exchange for the common shares of Subco A1.

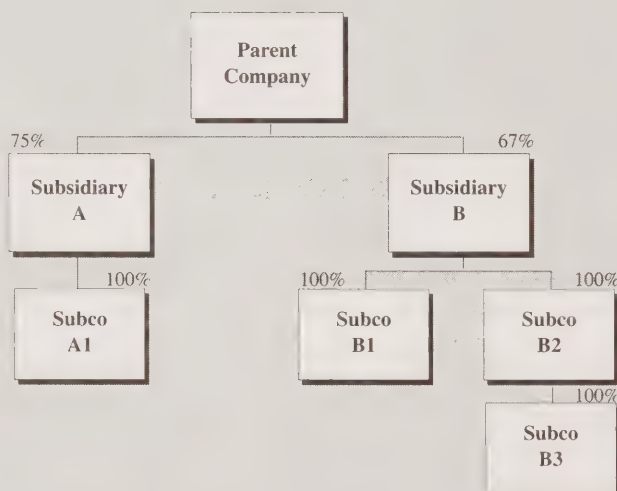


Exhibit 37.5 (cont'd)

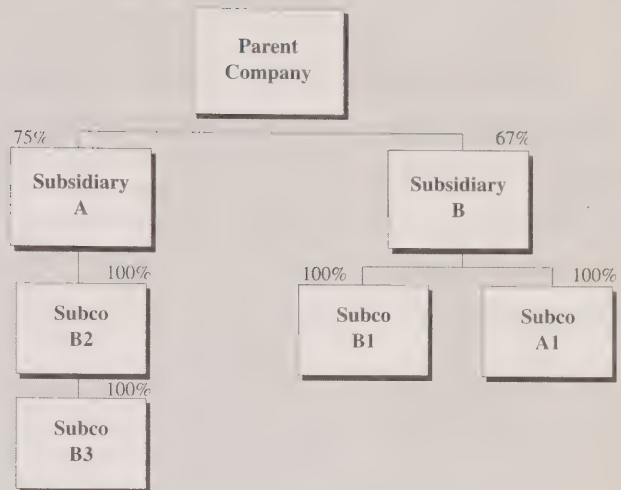
The structure now looks like this.

Step 5:

Subco A1 and Subco B1 are amalgamated under the rules of the *Income Tax Act* to form Amalco. Amalco is now able to use the \$60 million of Subco A1's tax losses carried forward to reduce its taxes in the future.

Step 6:

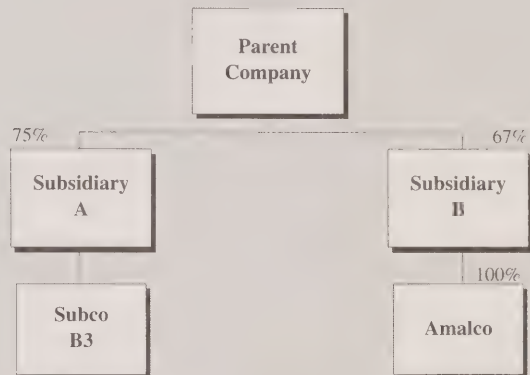
Subco B2 is wound up under the rules of the *Income Tax Act*.



The structure now looks like this.

Step 7:

Subsidiary A transfers some of its investments in companies that it controls to Subco B3 on a tax-free basis in exchange for interest-bearing notes and preferred shares. Since Subsidiary A has losses carried forward it pays no tax on the interest income it receives from Subco B3. The interest expense incurred by Subco B3 creates large losses that are carried back to prior taxation years to claim refunds of taxes previously paid amounting to \$100 million.



of mutual concern and interest, including legislation.

Globalization of business brings more complexity

37.32 Business is increasingly conducted without regard to borders. This presents particular challenges for a government to ensure that multinational corporations pay their fair share of tax on operations conducted in that country. Different types and levels of tax in different countries present multinational corporations with many tax-planning

opportunities as they seek to minimize their global tax burden. For example, Chapter 11 of our May Report gives several examples of how offshore service companies claim that tax havens can be used to reduce taxes.

37.33 As well, when a company transfers raw materials, manufactured goods or services between countries, the price used for the transfer is critical in determining where profits and losses are recorded and, consequently, where taxes are paid.

37.34 Revenue Canada has recognized that international transactions represent an area of high risk to the Canadian tax base. A separate directorate has been established to specialize in the taxation of international transactions. Specialized auditors are also available to provide expertise and assistance to other auditors when they encounter international transactions in their audits.

37.35 In the large file program, we observed that most case managers referred certain international issues to the international auditors. However, to date there have not been as many referrals of transfer-pricing issues as we would have

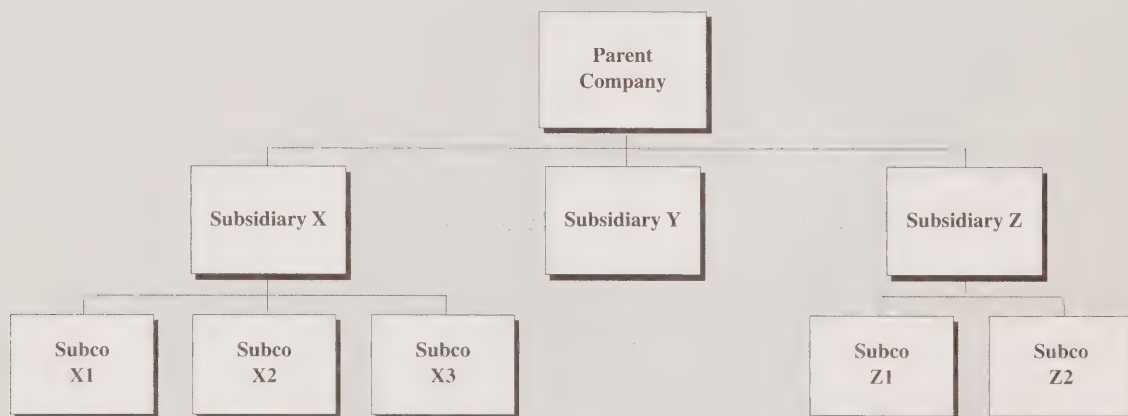
expected. The case managers we talked to said they were aware of the potential risks presented by transfer prices. At the same time, some said that an audit of transfer prices is time consuming and can be undertaken only when resources permit.

37.36 As the Department becomes more experienced with transfer-pricing audits and more resources are made available, as is planned, we would expect to see an increase in the number of transfer-pricing audits conducted for the multinational corporations in the large file program. To date we have not conducted an audit of the International Directorate, and did not include it in the scope of this audit. We

Exhibit 37.6

Example of Loss Creation Using Interest

1. Parent Company is a public corporation whose assets are primarily investments in other corporations. Parent Company's main source of income is tax-free dividends. It has significant amounts of interest expense incurred on funds borrowed to invest in a Netherlands subsidiary and for group financing. The interest expense and the tax-free dividends create losses for tax purposes.
2. Subsidiary X, Subsidiary Y and Subsidiary Z are holding companies.
3. Subco X1, Subco X2, Subco X3, Subco Z1 and Subco Z2 are the operating companies. They are profitable and pay taxes.
4. Parent Company loans \$650 million in total to Subco X1, Subco X2 and Subco Z1 at interest. Parent Company pays no tax on the interest income it receives because of its losses for tax purposes.
5. Subco X1, Subco X2 and Subco Z1 use the funds to purchase preferred shares of Subsidiary Y. Subsidiary Y pays dividends on the preferred shares thereby ensuring that Subco X1, Subco X2 and Subco Z1 can deduct the interest paid on their loans for tax purposes. The dividends are tax-free to Subco X1, Subco X2 and Subco Z1.
6. The interest expense creates losses in Subco X1, Subco X2 and Subco Z1 that are then carried back to prior years to claim a refund of taxes previously paid.



will follow up on this issue when we audit the activities of the International Directorate.

Management's response: a new approach

37.37 Senior management at Revenue Canada is well aware of the challenges the Department's auditors face. In an attempt to manage these challenges and to improve relations with taxpayers, management has devised a new approach to auditing large files. The approach, which was first announced by the Minister on 6 March 1995, is based on a co-operative, open and transparent relationship between the taxpayer and Revenue Canada.

37.38 The approach has three basic elements: the audit protocol, real-time audits and concurrent audits. The audit protocol seeks to increase the efficiency of the audit process and to enhance the compliance relationship between large corporations and Revenue Canada. It establishes a general framework for conducting audits, and a multi-year audit plan. Taxpayers who sign a protocol and request a real-time audit are expected to fully disclose all significant issues and the tax positions taken. Revenue Canada agrees to develop its audit plans in consultation with the taxpayer, to demonstrate that it has the right expertise to conduct the audit and to keep disruptions to a minimum. We note that the Department has now signed three protocols.

37.39 The second element in the new approach is real-time audit. As we point out in paragraph 37.65, Revenue Canada historically has audited tax returns several years after they are filed. Real-time audits seek to resolve issues more quickly and reduce audit time by dealing with them before the tax return is filed. Real-time

audits will be done only at the request of the taxpayer. The key to these audits is that the taxpayer must disclose its tax position on the issues subject to audit. Revenue Canada will then consider the tax position and carry out any necessary audit work. If there is agreement on the tax treatment, the corporation will file its return and Revenue Canada agrees not to re-audit the issue. If the parties cannot agree, a process has been established to resolve the issue.

37.40 The third part of the new approach is concurrent audits by Revenue Canada of more than one of the taxes it administers (for example, income tax and the GST). This approach is designed to increase audit efficiency for the taxpayer and for the Department.

37.41 The new approach to large business audit is just beginning to be implemented, so it is too early to tell whether it will be effective in helping auditors deal with the challenges they face. Improving the relationship between Revenue Canada and taxpayers should benefit both parties. At the same time, Revenue Canada will have to remain vigilant that its auditors retain the professional inquisitiveness required of all auditors.

More Improvements Needed in Selection of Audit Issues

Selecting the right issues to audit is a primary key to success

37.42 Selecting the right issues to audit, or scoping, is essential for a successful audit. Not only does it result in a more efficient audit and less disruption to the taxpayer, it also reduces the risk that significant errors will go undetected. Private sector auditors recognize this and focus heavily on the planning stage of the audit.

The new audit approach announced by the Minister is based on a co-operative, open and transparent relationship between the taxpayer and Revenue Canada.

Improving the relationship between Revenue Canada and taxpayers should benefit both parties.

Revenue Canada is increasingly looking to specialists to help case managers select their audit issues and conduct the work.

37.43 In recent years, Revenue Canada too has recognized the need for more effective issue selection. With the increasing challenges facing auditors and a reduction in the resources available for each audit, it is important to select the right issues and to focus the audit effort on those issues. For Revenue Canada, the right issues are generally those involving the greatest risk of non-compliance.

Use of specialists and selection tools is growing

37.44 Revenue Canada is increasingly looking to specialists to help case managers select their audit issues and conduct the work. There are specialists in particular tax areas such as international taxation and tax avoidance and there are specialists in particular industries such as oil and gas and banking. These specialists help the case manager to decide which issues present greater risks of non-compliance. We observed that some case managers used specialists regularly, whereas others seldom consulted with them.

37.45 For example, case managers are responsible for consulting with tax avoidance specialists when they suspect tax avoidance, and for referring specific cases to Tax Avoidance for investigation and reassessment where appropriate. We note that there were 11 referrals in 1993–94, 27 in 1994–95 and 27 in 1995–96.

37.46 Our discussions with case managers revealed that some have a background in tax avoidance and prefer to investigate and reassess tax avoidance cases themselves, in consultation with the specialists. This is particularly so in the Toronto office, where the number of referrals is low. In the Calgary office, tax avoidance auditors routinely review large

corporations' files for tax avoidance issues early in the audit process.

37.47 Under the Department's revised policy on team audits, the large file case manager will be responsible for managing the compliance relationship with the taxpayer and for co-ordinating the work of all specialists. As well, the policy calls for the participation of specialists, including tax avoidance specialists, in selecting audit issues and in auditing specialized areas. In our view, this policy, if fully implemented, should improve the detection and reassessment of avoidance schemes and other forms of non-compliance. We also believe further improvements are required and these are discussed in paragraphs 37.50 to 37.57.

37.48 The Department is committed to increasing the number of industry specialists and has a plan to do so. Our discussions with industry specialists and auditors suggest that this is a wise move. Industry specialists need to liaise with industry organizations and keep abreast of current developments, and to bring these to the attention of auditors. They also need to help ensure more consistent assessing practices within particular industries.

37.49 The Department is also starting to provide its auditors with more industry-specific guidelines on the types of issues to look for. These are largely based on issues other auditors have found and reassessed, as well as on input from the industry specialists.

Need for more top-down analysis by case managers

37.50 While the use of industry specialists and selection tools is growing and should help case managers select the right issues to audit, we believe that further improvements are required.

37.51 Case managers normally select the issues to audit by reviewing the tax returns for the years to be audited, the company's published annual reports and the previous audit report. Based on this information, their own knowledge of the company and its industry, and the advice of specialists, they then select the issues to be audited.

37.52 We found that in many cases the same issues were audited for several years. There are several possible explanations for this. First, the issues could be those that present the highest risk of non-compliance. The fact that reassessments were often raised on these issues indicates that Revenue Canada believed there was non-compliance. However, many of these same issues have been appealed by the taxpayers and it will ultimately be up to the courts to decide whether there was non-compliance with the laws.

37.53 Second, because the audits are done several years after the returns are filed, it can take taxpayers some time to revise their filing practices even when they agree with Revenue Canada's assessing position. Therefore, auditors have to keep auditing these issues until they catch up to the point at which the taxpayer made the change.

37.54 Third, the auditors may simply be comfortable with certain issues and reasonably confident that they can find discrepancies and raise a reassessment.

37.55 We would expect a high level of involvement of case managers throughout the issue selection exercise, but particularly at the beginning. In most cases, we found this to be true. We would also expect case managers to begin the exercise by assessing the company and its management for the likelihood of non-compliance. Exhibit 37.7 sets out

some possible questions that could be asked as part of such an assessment. Information gained in previous audits is a useful input to the assessment.

37.56 We found little documentation supporting this kind of systematic, high-level, risk-based approach to issue selection. As well, our discussions with case managers indicated that they were not, on a regular basis, asking the kinds of questions shown in the exhibit.

37.57 In our view, top-down analysis is one of the keys to successful issue selection. When coupled with the active advice of industry and other specialists, this analysis should give case managers and senior management the assurance that all high-risk areas of non-compliance have been reviewed. Based on our observations in paragraph 37.56, we believe that case managers need additional training to carry out such an analysis properly.

Lack of effective quality control over issue selection decisions

37.58 Case managers are responsible for selecting the issues to audit, in consultation with all team members and specialists. We observed that their decisions are seldom challenged. The only real check is whether the case manager is able to raise a reassessment at the end of the audit. In our view, this does not give senior management sufficient assurance that the best issue selection decisions have been made and that all high-risk areas of non-compliance have been reviewed and reassessed where necessary.

37.59 We believe that some degree of challenge is needed at an early stage in the audit. This should not only help case managers make better issue selection decisions but also improve the efficiency of the audit from the taxpayer's perspective and provide management with

We found little documentation supporting a systematic, high-level, risk-based approach to issue selection.

better assurance about the effectiveness of the audits.

37.60 The challenge need not be burdensome and could be accomplished by having another case manager act as a reviewer. The role of the reviewer would be to discuss the strategic analysis with the case manager responsible for the audit, to confirm that the appropriate specialists had participated in the scoping decisions and to raise any questions or concerns that he or she had. It is important that the reviewer be at least at the same level as

the case manager to ensure a credible process. There are also other models for achieving an effective challenge of issue selection decisions.

Better documentation of issue selection is needed

37.61 The audit plans we reviewed were essentially audit programs or listings of audit procedures. These represent the result of the issue selection decisions and what the auditor intends to do; however,

Exhibit 37.7

**Possible Steps and Questions
for Assessing High-Level Risk**

- 1. Assess the personal characteristics, philosophy and operating style of the individuals who comprise an entity's management, as these have a significant influence on the entity as a whole.**
 - Does management appear willing to accept unusually high levels of risk?
 - Has management frequently changed banks, attorneys, or auditors?
 - Has management failed to engage reputable professional third parties?
- 2. Assess management's overall commitment to accurate self-assessment of taxes and the auditor's ability to rely on management's representations.**
 - Does management tend to interpret tax legislation aggressively?
 - Do transactions without substantial economic justification exist?
 - Are there a significant number of related-party transactions?
- 3. Understand the taxpayer's business.**
 - What are the key internal factors that affect the taxpayer's business and tax returns (such as ownership and management structure, finance and personnel)?
 - What is the taxpayer's global effective tax rate?
 - What are the significant external factors that affect the taxpayer's business and the tax returns (such as industry matters and general business environment)?
 - Are there particular industry risks for this taxpayer?
 - What are the key elements of the management control process?
- 4. Perform preliminary analytical procedures to help identify unusual or unexpected balances or adjustments and relationships that may indicate a specific risk of non-compliance.**
- 5. Assess the risk of non-compliance for particular tax accounts, transactions or adjustments from accounting income to taxable income.**
 - Are there unusual or complex transactions?
 - Is there an unusual degree of management involvement in particular transactions or adjustments?
 - Are there transactions with related parties? Have they changed from prior periods?
 - Has there been a history of error in particular accounts, transactions or adjustments?
 - Are there changes to the corporate structure, and what effect do they have on taxes?

they do not summarize the basis on which those decisions were reached.

37.62 We believe that better documentation of issue selection is needed to provide senior management with the assurance that the right decisions have been made and the highest-risk areas of possible non-compliance are being reviewed, and to provide subsequent case managers with valuable information on the taxpayer.

37.63 **Revenue Canada should train its case managers to do more strategic analyses of their cases, implement a challenge review of issues selected for audit and ensure that the rationale underlying the selection of the issues is adequately documented.**

Department's response: Revenue Canada has implemented training sessions for its case managers on strategic analysis techniques. The Department will implement a challenge review process for issue selection over the next 18 months. It will also take steps to ensure that issue selection decisions are properly documented as part of its ongoing Quality Assurance Program.

Revenue Canada Is Dealing with the Problem of Currency of Audits

Audits are being done several years after filing

37.64 Corporations have up to six months after a year-end to file a tax return. For example, a corporation whose year-end is 31 December has until 30 June of the following year to file its return. Revenue Canada examines the return and sends a notice of assessment to the taxpayer. For public corporations, Revenue Canada can issue reassessments during the next four years. At the end of the four-year term, the tax return becomes

statute-barred and can be kept open only if the taxpayer chooses to file a waiver.

37.65 Until recently, the audits of large corporations have often been conducted close to the statute-barred date. For example, consider that Corporation A has a 31 December year-end. It files its return for the year ended 31 December 1990 on 30 June 1991. A notice of assessment is issued by Revenue Canada on 15 August 1991. Revenue Canada has until 15 August 1995, or later if a waiver was given, to audit the 1990 return and issue a notice of reassessment, if applicable.

37.66 Auditing returns several years after they were filed has caused problems for taxpayers and for Revenue Canada. It meant that old records had to be retrieved and taxpayers had to provide explanations for transactions that had occurred several years before. Sometimes records were misplaced and the taxpayer's personnel had changed, causing difficulty in substantiating tax positions. Delays were frequent and resulted in frustration for all concerned.

37.67 The fact that interest on reassessments is not deductible is a significant incentive for taxpayers to comply with the laws when filing their returns. However, when audits are conducted several years after filing, interest charges can sometimes exceed the taxes owing. When the amounts are in the millions of dollars, taxpayers object strenuously and this adds considerably to the time and effort needed by both parties to resolve the issues.

Management has an action plan and targets have largely been met

37.68 In 1994 management developed an action plan to reduce the time lag between the time a return is assessed and the time it is audited. The goal was to have all audits for 1992 and prior taxation

Until recently, the audits of large corporations have often been conducted close to the statute-barred date.

years completed by 31 March 1996, and audits for the 1993 and 1994 taxation years started by that date. Using our earlier example, Corporation A, the 1992 tax return filed on 30 June 1993 would have been assessed on 15 August 1993. The statute-barred date would be 15 August 1997. By having the audit completed by 31 March 1996, Revenue Canada has reduced the time lag by about 18 months.

37.69 At 31 March 1996, Revenue Canada reported that it had made good progress with this initiative: about 83 percent of the cases met or substantially met the target and less than 7 percent were seriously behind the target. Revenue Canada has now revised its target to have all audits for 1993 and prior taxation years completed by 31 March 1997. Ultimately, the objective is to audit each large corporation once every two years. The audit would cover the two most recently assessed returns.

37.70 We support this initiative, as we see benefits for both taxpayers and Revenue Canada. We also recognize that there is a cost involved in meeting these targets. In most cases, there was no increase in the resources used to do the audits. Some of the case managers we talked to said that they were restricting their audits to previously identified issues and were not exploring new issues until their cases were current. In our view, this and the need for improvements in the issue selection process pose a risk that significant amounts of revenue properly due the Crown will not be reassessed. This may be an acceptable trade-off to achieve the benefits of currency, but management is not able to indicate the cost of the initiative in terms of possible missed reassessments.

Measured and Reported Results Do Not Give a Complete Picture

Published results indicate a large return per audit hour

37.71 Exhibit 37.8 sets out the performance information on the large file program, which forms part of Appendix C-1 of Revenue Canada's Part III of the 1996–97 Estimates. The Part III indicates that Revenue Canada's overall compliance activities for 1994–95 resulted in \$4.2 billion in additional federal and provincial (for participating provinces) tax assessed. The total federal impact of \$1.3 billion for 1994–95 forms part of the \$4.2 billion. The Part III also indicates that, of all of Revenue Canada's verification and enforcement programs, large business audits (which include those done in the large file program) provide the largest total fiscal impact per file audited.

37.72 In our view, these results fairly reflect the auditors' contribution to the final reassessment or refund of taxes. At the same time, we note that the government accounts for its tax revenues on a cash basis. We did not find any information in Part III that took this into account. We believe that the information currently being reported needs to be supplemented with further disclosures on the cash impact of audits. Our reasons are set out below.

Results show auditors' efforts but not actual amounts billed or refunded to taxpayers

37.73 Revenue Canada has a sophisticated system for analyzing the results of its audits. When a taxpayer receives a reassessment at the end of an audit it can include several items, for example, items the auditor found, the carry-forward effect of items that a previous auditor had found, and

The information
currently being
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further disclosures on
the cash impact of
audits.

adjustments that the taxpayer had requested. The system is designed to analyze the reassessment and isolate the auditor's contribution to it. Exhibit 37.9 sets out two examples of how this works.

37.74 Revenue Canada has spent considerable effort developing this system and it can provide useful information to management. At the same time, we believe that the information does not provide a complete picture. We have seen cases where the auditor has increased the amount of net income for tax by substantial amounts but the taxpayer has requested offsetting adjustments, so that there is no increase in taxable income and no increase in taxes. We have also seen cases where the audit adjustments have the potential to affect only future taxes

because the taxpayer is not currently taxable, due to such items as losses carried forward or deductible dividends. In situations such as these, a significant gain is reported because of the adjustments made by the auditor, but the fact that no additional taxes were billed is not reported. We believe that both amounts are needed to provide Parliament and management with a more complete picture both of auditors' efforts and of the actual amounts billed or refunded to taxpayers.

Results do not include subsequent appeals that may change the amount billed

37.75 Taxpayers have the right to object to a reassessment. When they do, Revenue Canada's Appeals Branch reviews the reassessment and confirms, varies or

Exhibit 37.8

Performance Information on the Large File Program Included in Part III of the Estimates

	Actual 1994-95	Actual 1993-94	Actual 1992-93	Actual 1991-92
Current Federal Impact (\$000)				
– Additional Tax Assessable ¹	339,381	344,571	252,431	339,616
– Refunds Offset/Reduced ²	290,029	346,700	353,115	443,250
– Interest Assessable	219,917	256,624	240,190	404,144
– Penalties Assessable	878	740	1,002	11,998
Net Present Value of Future Tax Assessable (\$000) ³	459,091	334,149	156,667	241,857
Total Federal Impact	1,309,296	1,282,784	1,003,405	1,440,865
Files Audited	613	634	552	518
Associated FTE ⁴	286	276	249	237

Notes:

- ¹ Additional tax assessable represents the total federal tax that will be raised as a result of the adjustments identified by the auditor for the taxation years audited.
- ² Refunds offset/reduced represents the amount of understated federal tax identified by the auditor that, instead of generating additional tax assessable, was used to offset or reduce a written request for a refund.
- ³ Net present value of future tax assessable is a discounted figure of tax that may be assessable in future years as a result of the adjustments identified by the auditor for the taxation years audited.
- ⁴ FTE is full-time equivalents, a measure of human resources used.

Source: Derived from Revenue Canada 1996-97 Part III Estimates

vacates it. Reassessments in the large file program are often for millions of dollars in additional tax and interest, and taxpayers regularly object when they disagree with Revenue Canada's interpretation. Further appeals to the courts are also possible if the taxpayer is not satisfied with the outcome of the objection.

37.76 The results reported for the large file program do not include any information on objections and appeals. Therefore, it is impossible to tell what portion of the reported results have been appealed and what portion of the appeal

has been confirmed, varied or vacated. Revenue Canada has advised us that it plans to start tracking this information.

37.77 We realize that appeals through the courts are often lengthy and that presenting information on them could clearly distort current-year figures. At the same time, we note that the settlements currently being negotiated on adjustments to resource allowance claims are almost entirely with corporations in the large file program, and will likely result in refunds of tax and interest of well over \$1 billion. This fact needs to be reflected in Part III because the auditor's adjustment to reduce

Exhibit 37.9

**Reconciliation of Reported
Audit Results with Actual
Reassessments or Refunds**

Case 1: An audit of Corporation A's 1991 tax return	
Net federal impact of the audit before interest and penalties, as reported in Part III of the Estimates	\$ 6,935,549
Deduct present value of possible adjustments to future years' taxes resulting from the 1991 audit	(5,131,847)
Deduct items found by the auditor that will be reassessed to another taxpayer	(29,786)
Deduct adjustments given to the taxpayer that reflect the 1991 portion of issues identified in audits of earlier tax years	(3,590,715)
Deduct adjustments that were requested by the taxpayer and agreed to by the auditor	<u>(13,748,933)</u>
Actual refund of federal taxes received by the taxpayer at the end of the 1991 audit	\$ (15,565,732)
Case 2: An audit of Corporation B's 1989 tax return	
Net federal impact of the audit before interest and penalties as reported in Part III of the Estimates	\$ 21,481,197
Add present value of possible adjustments to future years' taxes resulting from the 1989 audit	10,610,093
Deduct adjustments given to the taxpayer that reflect the 1989 portion of issues identified in audits of earlier tax years	<u>(6,152,591)</u>
Actual federal tax assessed to the taxpayer at the end of the 1989 audit	\$ 25,938,699

Note:

Both of these reassessments have been objected to and Revenue Canada's Appeals Branch has not released its decision. Therefore, the actual amounts refunded or assessed may change. However, any changes will not be reflected in the results reported in Part III of the Estimates.

the resource allowance may have been reported as additional tax assessable.

37.78 We reviewed through the appeal stages a sample of large file returns that had been reassessed for the 1987 taxation year, to determine the final effect on results reported for the large file program. We found that about 35 percent of the amounts reassessed were still outstanding, in various stages of appeal. Although these amounts were reassessed by auditors in the large file program and were reported to Parliament as part of the results of the program, they may be overturned in the future.

37.79 We believe that for a more complete picture, more information needs to be provided to Parliament and to management about the dollar impact of objections and appeals on the reported results of the large file program. We realize that this is not an easy exercise, given the time lags involved, but we are convinced the benefits will be worth the effort.

37.80 **Revenue Canada should supplement the information currently reported to Parliament on the results of the large file program with information on actual taxes billed or refunded and information on subsequent appeals.**

Department's response: In the context of the Treasury Board's Improved Reporting to Parliament Project, Revenue Canada will actively review areas where the information provided to parliamentarians can be enhanced.

Levels of compliance are not adequately measured

37.81 The overall objective of the large file program is to enhance compliance in the large file population. Measuring whether the program is successful in

meeting this objective is a difficult task. It involves measuring levels of non-compliance using several indicators, and examining their trends over a number of years. Non-compliance can occur both in areas that Revenue Canada audits and in areas that it does not.

37.82 Revenue Canada uses several indicators to measure the results of all of its audit programs. These indicators are based on completed audit work and so they give an indication of that segment of non-compliance. What they cannot do is measure the level of non-compliance in areas that have not been audited. Therefore it is difficult, based on the available data, to draw conclusions about the overall level of compliance in the large file population and whether the program is having any effect on that level of compliance.

37.83 The Compliance Research Directorate at Revenue Canada is beginning to collect data that will allow it to analyze the levels of compliance in particular taxpayer groups and industry sectors. We are encouraged by this effort, as we believe it should provide management and Parliament with useful information and allow Revenue Canada's auditors to be more effective.

37.84 **Revenue Canada should accelerate its efforts to analyze the level of compliance by the taxpayers in the large file program.**

Department's response: The establishment of the Compliance Research Directorate has significantly enhanced the Department's ability to analyze non-compliance in all sectors, including the Large File Program. This capacity will be accelerated as this function matures over the next 12 to 18 months.

It is difficult to draw conclusions about the overall level of compliance in the large file population.

**Attempts to fill
vacant positions
have encountered
difficulties.**

**A Number of Human Resource
Problems Are a Barrier to
Achieving Better Results**

**An adequate, competent and motivated
work force is essential**

37.85 The large file program is delivered primarily by case managers and auditors in the field. Thus an adequate, competent and motivated work force is essential to achieving better results for both taxpayers and Revenue Canada. Attracting and maintaining the necessary work force can be achieved through developing the current work force, hiring new people with the right skills, and providing a suitable work environment that enables personal growth and career progression. Because they deal with intricate tax issues in a changing global economy, large file case managers and auditors in particular need to be highly skilled. They are expected to interact with senior people in the largest corporations and with tax professionals in the private sector. They are also expected to exercise good judgment when interpreting complex tax law. Most of the case managers and auditors we talked to took pride in their work and derived satisfaction from the intellectual challenge it provides.

**A number of staffing issues need to be
resolved**

37.86 We observed that there were a number of staffing issues in regions or some of the Tax Services Offices handling large files that need to be resolved. One such issue concerns gaps between the level of resourcing considered necessary by managers of the large file program at headquarters and the level budgeted and actually used in the regions or Tax Services Offices. Although Tax Services Offices used more than 97 percent of the resources allocated to large files between

1992–93 and 1995–96, we noted that since the decision to allocate more resources to the large file program in 1994–95, the rate of underutilization in some regions has increased. As Exhibit 37.10 shows, in 1994–95 and 1995–96, the gap in Southern Ontario — the largest region for this program — averaged 15 percent. In 1995–96, the gap between the level of resources allocated to both Southern Ontario and Quebec and the actual numbers used was close to 14 percent. In contrast, smaller regions in Western Canada, for example, have consistently used close to or more than the resources allocated.

37.87 Some of the reasons given by management for the gaps were:

- retirements and unexpected resignations of experienced staff;
- inability to hire from the outside;
- inexperienced junior staff to qualify for promotions;
- transfer of resources to other priority programs, such as the Tax Avoidance and the Industry Specialist programs;
- the addition of a large number of files to the program at the beginning of the year and problems in obtaining staff;
- staffing actions not finalized due to appeals; and
- disruptions due to changeover of staff when competitions are finalized.

37.88 We have also noted that attempts to fill vacant positions have encountered difficulties. For the large file program, staffing problems continue in a cycle of competitions, appeals and acting appointments. In most instances, internal competitions were conducted to select qualified candidates in accordance with the *Public Service Employment Act*. However, appointments could not be finalized pending the resolution of

appeals; a single appeal can delay several appointments. In the interim, assignments or acting appointments are used in order to meet operational requirements. These can cause problems for future competitions, if used over a long period, as they can be perceived to give an unfair advantage to some employees. One of the competitions was first initiated over two years ago, and final appointments have not yet been resolved due to appeals. Case managers and auditors perceive that such situations have negative effects on the work environment, including uncertainty, instability and frustration. Furthermore, as reported by management and noted above, once competitions are finalized, changeover of staff may cause disruptions in the work.

37.89 Some of the delays in resolving staffing problems in the large file program originate from the complex, paper-ridden and at times frustrating employment system of the public service. However, we believe that better planning to anticipate the need for appropriate staff, and more timely staffing actions; could help reduce delays and minimize the effects of other problems noted. Possibilities for improvements include:

- statements of qualifications or selection profiles that provide a clearer indication of experience, skills and traits required of potential internal or external candidates, so that they can better assess their interest and their chances of success;
- focussed and dynamic external recruitment strategies that take into account the fact that skilled candidates required for large case files at senior levels are rare and in demand in the private sector. Potentially good external candidates may lose interest if they have to wait for long periods before interest in their skills is shown;

- deciding on the selection strategy, process and techniques before internal and external competitions are even announced, and more timely development of selection tools such as interviews and written examinations; and

- screening applications as they come in, instead of waiting weeks.

37.90 Revenue Canada should improve its processes so that the resources considered necessary for the effective and efficient delivery of the large file program are available and used, especially in key regions, on a timely basis.

Department's response: The Department staffs positions as expeditiously, efficiently and cost-effectively as possible to meet its operational objectives and to do so within the parameters established by the Public Service Employment Act and Regulations. Revenue Canada will improve those aspects of planning and staffing processes that are under its control. As part of the monitoring of resource utilization, the Department will continue to monitor whether staffing processes have been initiated in the regions to ensure that the planning for full resource utilization for delivery of the Large File Program is performed in an effective manner.

37.91 Revenue Canada should, in collaboration with stakeholders such as managers, the Public Service Commission and employee representatives, examine further what measures can be taken to improve the efficiency of the staffing process, such as reducing unnecessary delays and paper burden, while allowing for a proper mix of promotional opportunities and external recruitment.

Department's response: The Department is continually examining areas where its internal staffing processes can be streamlined. In addition, senior departmental managers work actively with

Staffing problems continue in a cycle of competitions, appeals and acting appointments.

Utilization of Resourcing Levels 1992-93 to 1995-96

Region	1992-93			1993-94			1994-95			1995-96		
	FTEs* Allocated by HQ	FTEs Budgeted by Region	FTEs Used	FTEs Allocated by HQ	FTEs Budgeted by Region	FTEs Used	FTEs Allocated by HQ	FTEs Budgeted by Region	FTEs Used	FTEs Allocated by HQ	FTEs Budgeted by Region	FTEs Used
Atlantic	4.9	4.9	5.9	5.9	5.8	9.3	11.0	9.9	10.1	11.0	10.4	9.7
Quebec	71.4	71.6	76.6	71.4	82.6	85.3	99.0	95.4	93.5	99.0	93.9	84.4
Southern Ontario	109.5	108.6	102.8	108.5	108.6	104.0	130.0	116.5	108.3	130.0	123.0	113.0
Northern Ontario	3.0	3.0	3.1	3.0	1.7	2.6	3.0	2.1	1.7	3.0	2.5	2.0
Prairie	54.2	51.7	53.1	54.2	56.5	54.5	60.0	60.6	52.5	60.0	64.1	70.4
Pacific	14.3	16.1	14.6	14.3	19.2	22.4	14.0	20.4	19.0	14.0	20.6	19.7
All Canada	257.3	255.9	256.1	257.3	274.4	278.1	317.0	304.9	285.1	317.0	314.5	299.2

*Full-time equivalents

Source: Revenue Canada

the Public Service Commission to improve the staffing regime in the public service as a whole.

Certain aspects of management of change need to be improved

37.92 Recognizing the need for more staff and experts to deal with the increasing complexity of many cases in the large file program, the Department created a number of new positions. It is intended that these new positions will apply to case managers for the most complex cases as well as to the Department's industry specialists. Although senior management has invested significant time and effort to meet with staff and explain the change and its potential effect on them, and has provided opportunities for enquiries, we found that some employees were still apprehensive about the change and its impact. Because they perceived that the creation of the new positions could lead to a significant reduction in the number of other positions and to important changes in work assignments, these employees remained concerned about how it would affect their careers and the work they value so highly. The staffing problems described in paragraph 37.88, compounded by this apprehension, have resulted in tensions in the work environment that will require ongoing attention from senior management.

37.93 We found that other initiatives such as the introduction of formal protocols with large corporate taxpayers initially met resistance from the field offices because, in this case, staff in the field perceived that consultations took place after the concept had been developed at headquarters. As a result, some case managers and auditors were not convinced of the need for or value of such initiatives. However, we noted that

headquarters has made efforts in the past year to solicit input from the field and to disseminate information on headquarters' initiatives; for example, the Large File Steering Committee was established for this purpose. We encourage the Department to continue its efforts to reduce tensions in the work environment and to achieve greater buy-in and acceptance of headquarters' initiatives.

37.94 Revenue Canada, in collaboration with employee representatives and managers in the field, should continue its efforts aimed at reducing the level of apprehension in the work place, including measures to speed up the staffing process and to improve the management of change.

Department's response: The Department will continue its comprehensive program of consultation and communication with managers, staff and unions.

Environment That Fosters Learning and Continuous Improvement Needed

Large file auditors are professional, knowledge-based workers

37.95 The large file case managers and auditors are professional, knowledge-based workers who enjoy doing challenging work. They need to have up-to-date training and to work in an environment that encourages continuous learning in order to meet the challenges of increasing complexity in the business world and in related tax and accounting issues. The need for such a learning environment is recognized by the Department. The *Guiding Principles for Learning in Revenue Canada* and the *Accountability Framework for the Management of Training, Development and Learning in Revenue Canada* were recently endorsed by senior management

The large file case managers and auditors are professional, knowledge-based workers.

**More emphasis needs
to be placed on
ensuring that case
managers and
auditors have the
appropriate skills.**

to implement the concept of a learning environment.

37.96 We encourage the Department to proceed with implementing these initiatives as quickly as possible. We believe it is especially important that those responsible for managing the large file program take proactive steps to develop an environment or culture that fosters learning, continuous improvement and professionalism.

More learning opportunities are needed to help increase auditors' knowledge and performance

37.97 As we point out in paragraph 37.42, selecting the right issues to audit is essential for a successful audit. An auditor or case manager needs a wealth of knowledge to help in this process. Encouraging case managers and auditors to interact with other knowledgeable people from inside and outside Revenue Canada is one of many ways to obtain, maintain and upgrade this knowledge, as well as to improve performance. Team peer interaction and participation in task forces and committees can also provide learning opportunities.

37.98 We observed several examples of such initiatives. Many case managers and auditors frequently consult industry specialists. As well, Revenue Canada periodically arranges conferences to discuss technical issues. For example, national conferences with selected case managers from every Tax Services Office are held about every two years. Furthermore, conferences for case managers and auditors who audit particular industries are also held from time to time. Such conferences can be excellent opportunities for case managers and auditors to discuss the complexities they face and to learn from each other.

37.99 We are convinced that the benefits of these opportunities for learning could be extended while keeping costs at a reasonable level. For example, the Large File Steering Committee recently recommended that meetings be held in the different regions before and after Steering Committee meetings. The feasibility of this proposal is being explored. We believe that such meetings could also take place before and after the national conferences.

37.100 We also believe that opportunities exist for additional training. Given the current emphasis on team audits, we expected staff to have taken training in teamwork and team-building skills. Our review of the training taken by a sample of case managers and auditors found that very few courses of this type were taken. In our view, more emphasis needs to be placed on ensuring that case managers and auditors have the appropriate skills for teamwork and for implementing other departmental initiatives.

37.101 We also noted that opportunities for self-learning can be increased. We found few instances where staff at Tax Services Offices have had the opportunity to organize meetings or conferences on tax subjects of particular interest to them, or to exchange knowledge on tax and other technical issues as well as best practices. Such opportunities could provide a valuable supplement to self-study programs currently provided by the Department.

37.102 Revenue Canada should expand learning opportunities for case managers and auditors to ensure that they have the appropriate skills to effectively implement departmental initiatives and to learn about or discuss

technical and other issues of particular interest and importance to them.

Department's response: The Department is taking steps to enhance learning opportunities through: 1) the implementation of team building consultation services offered by its Training Development organization; 2) the institution of formal training programs such as the Reaching Agreement Program, which includes the concept of team-based audits; and 3) the development of ongoing team intervention processes.

Tax Services Offices normally hold meetings two or three times a year to discuss tax subjects of particular interest to them. These Offices will be encouraged to expand their use of these meetings. It should be noted that it is the policy of Revenue Canada that best practices be shared across the organization and issues arising from these meetings will be communicated accordingly.

Revenue Canada believes that it has a robust training program for both case managers and auditors. However, over the next 12 months, the Department will

review areas where enhancements can be made.

Conclusion

37.103 Revenue Canada's large file program provides a co-ordinated approach to auditing the tax returns of the largest and most complex corporations. Management has paid considerable attention to the program and has several initiatives in place to improve it.

37.104 We found that Revenue Canada's auditors face many challenges in doing their work and our report outlines some of those challenges. At the same time, we note that auditors are reassessing many issues, often resulting in significant dollar returns to the government.

37.105 Our report has also identified opportunities for improvement in the areas of issue selection, measurement and reporting of results, and human resource management that we believe could further strengthen the large file program.



About the Audit

Objective

Our audit objective was to determine whether significant opportunities exist to improve the assessment and collection of tax revenues from the large file program.

Scope

Our examination included a review of the large file program operations and related activities at headquarters and in selected Tax Services Offices.

Criteria

We would expect Revenue Canada to:

- have adequate processes to ensure that its auditors identify likely instances of non-compliance when selecting issues for audit, conduct audits on a timely basis, and develop sustainable assessing positions;
- have systems to measure results and the effectiveness of the program;
- fully and fairly report program results to Parliament;
- have appropriate policies, systems, processes and practices to attract and motivate the work force and to provide an enabling environment to learn and perform; and
- identify areas where there are weaknesses in the legislation and report them to the Department of Finance on a timely basis.

Audit Team

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**Report of the
Auditor General
of Canada
to the House of Commons**

Chapter 38
Follow-up of Recommendations
in Previous Reports

Chapter 39
Other Audit Observations

Appendices

November 1996

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The follow-up work was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants.

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Follow-up of Recommendations in Previous Reports

Main Points

38.1 Departments are taking action to correct deficiencies noted in our previous reports; however, progress is slow in some areas.

38.2 Federal Management of the Food Safety System. The new Canadian Food Inspection Agency is being created to consolidate all federally mandated food inspection and animal and plant health programs. It is intended to make the federal food inspection programs more efficient and effective, at a lower cost to the taxpayer.

38.3 Safety and inspection practices are not yet risk-based and consistent across products and industries, the frequency of plant inspections remains inconsistent, and frequency targets are often not met. Although this situation does not compromise health and safety, it will persist until common standards are finalized and inspection programs are revised.

38.4 Atomic Energy Control Board (AECB) – Canada's Nuclear Regulator. Recent initiatives undertaken by the AECB represent both a commitment to revitalize the organization and a considerable effort to address our audit concerns. However, much remains to be done.

38.5 The resolution of more than two thirds of our audit concerns is dependent in whole or in part on the outcome of proposed new legislation currently before Parliament. In our opinion, without updated legislation, the AECB remains limited in its ability to fulfill its mandate. However, as noted in our 1994 audit, new legislation by itself will not correct the deficiencies identified in the management processes and practices.

Introduction

38.6 Departments continue to take action to correct deficiencies noted in our previous Reports. However, as noted in this chapter and others that include follow-up, progress is slow in some areas. Many departments are still undergoing changes due to Program Review and downsizing, which continues to put pressure on their remaining resources. However, it is important that deficiencies be corrected as soon as possible, so that the remaining departmental resources are used in the most efficient and effective manner.

38.7 Observations and recommendations made in our Reports are normally followed up and their status reported in the annual Report two years after publication of the original chapter. This year, follow-up on 12 chapters has been reported in other chapters of our Reports, 17 chapters have had their follow-up deferred to future years, and there will be no formal follow-up on 5 chapters. Exhibit 38.1 summarizes the status of those chapters whose follow-up report would normally have been included in this chapter.

Status of Chapters Due for Follow-up in November 1996 but Not Included in This Chapter

Year & #	Chapter Title	Responsible Auditor	Follow-up Status
1992			
24	Emergency Preparedness in the Federal Government	Alan Gilmore	The follow-up report on nuclear emergencies will be delayed until after the Federal Nuclear Emergencies Plan is tested. Tentatively planned to report in 1998.
1993			
7	Internal Audit	Trevor Shaw/ Bruce Sloan	Reported in Chapter 4 of the May 1996 Report.
8	Program Evaluation in the Federal Government – The Case for Program Evaluation	Henno Moenting	Reported in Chapter 3 of the May 1996 Report.
9	Program Evaluation in Departments – The Operation of Program Evaluation Units		
10	The Program Evaluation System – Making it Work		
12	Canadian International Development Agency – Bilateral Economic and Social Development Programs	Vinod Sahgal	Reported in Chapter 29 of this Report.
19	Department of National Health and Welfare – Non-insured Health Benefits	Ellen Shillabeer	Deferred from 1995. Follow-up work on this chapter is being incorporated into a chapter on First Nations Health, planned for September 1997.
20	Department of National Revenue – Advance Income Tax Rulings GST Rulings and Interpretations	Barry Elkin	See Chapters 28 to 33 from 1994, in this exhibit.
22	Department of Transport – Airport Transfers	Hugh McRoberts	Deferred from 1995 as no further transfers had been made to airport authorities since our audit. Follow-up will be done after additional transfers take place. Tentatively planned to report in 1998.
27	Gun Control Program	Alan Gilmore	Cancelled, as the program that was reviewed in 1993 will be fundamentally changed by proposals being made to Parliament.
1994			
5	An Innovative Society and the Role of Government	Otto Brodtrick	These chapters contained the findings from studies undertaken by the Office and contained no recommendations, so they will not be subject to formal follow-up.
6	Study of Key Federal Social Programs	Louis Lalonde	
7	Information for Parliament: Departmental Reporting on Sectoral Activities and Follow-up of 1992 Chapter on Departmental Reporting	Jeff Greenberg	
8	Information Technology – Reaping the Benefits and Managing the Risks	Nancy Cheng	No formal follow-up was conducted for this study. Aspects of the Blueprint and the Chief Informatics Officer were included in Chapter 16 of the September 1996 Report.
9	Science and Technology – Overall Management of Federal Science and Technology Activities	Richard Flageole	Reported in Chapter 15 of the September 1996 Report.
10	Science and Technology – Management of Departmental Science and Technology Activities	Richard Flageole	Deferred, as the government will be implementing its new strategy on Science and Technology. Tentatively planned to report in 1998.

Exhibit 38.1 (cont'd)

Status of Chapters Due for Follow-up in November 1996 but Not Included in This Chapter

Year & #	Chapter Title	Responsible Auditor	Follow-up Status
1994			
11	Science and Technology – The Management of Scientific Personnel in Federal Research Establishments	Jacques Goyer	Follow-up on government-wide issues related to management of scientific personnel was reported as part of Chapter 15 of the September 1996 Report. Follow-up on management of scientific personnel in research establishments is deferred, as the government will be implementing its new Framework for the Management of Scientific Personnel. Tentatively planned to report in 1998.
12	Aspects of Federal Real Property Management	Reno Cyr	Deferred to allow departments time to reorganize after going through downsizing and restructuring. Tentatively planned to report in 1997. See Chapter 34 below.
16 17 18	Correctional Service Canada – Custody of Inmates National Parole Board Correctional Service Canada – Supervision of Released Offenders	David Brittain	Deferred to allow the entities additional time to take corrective action. A new Commissioner has just been appointed to Correctional Service Canada. Currently planned to report in 1997.
21	Foreign Affairs and International Trade Canada – Technical Assistance Contributions to Central and Eastern Europe and the Former Soviet Union	Vinod Sahgal	Reported in Chapter 29 of this Report.
22	Foreign Affairs and International Trade Canada – Financial Management and Control	John Hutchinson	Deferred to permit examination of new issues. Tentatively planned to report in April 1997.
24 25 26 27	National Defence – Defence Management Systems – Information Technology – Infrastructure Reductions – Infrastructure Management	Peter Kasurak	Reported in Chapter 35 of this Report.
28 29 30 31	Revenue Canada – Customs Assessment Activities – Collecting Income Tax Debts – GST: Audit and Special Investigations – Ensuring Fairness of the Income Tax System: Detection of Non-Filers and Special Investigations	Jim Ralston Basia Ruta Jim Ralston Jim Ralston/ Barry Elkin	Deferred so that the numerous issues identified may be followed up and reported together in a separate chapter. Tentatively planned to report in 1997.
32	Department of Finance and Revenue Canada – Income Tax Incentives for Research and Development	Barry Elkin	
33	Department of Finance and Revenue Canada – Tax Assistance for Retirement Savings	Barry Elkin/ Mike Adibe	
34	Public Works and Government Services Canada – Management and Operation of Crown-owned Office Buildings	Michael Weir	Deferred, as the follow-up work will be combined with another planned audit in the same area. See Chapter 12 above. In addition, program review and government downsizing will require a shift in focus for the follow-up, which would be hard to accommodate within a follow-up chapter segment. Tentatively planned to report in 1997.

Federal Management of the Food Safety System — 1994, Chapter 13

Assistant Auditor General: David Roth

Responsible Auditor: Bill Rafuse

The new Canadian Food Inspection Agency is intended to make federal food inspection programs more efficient and effective, at a lower cost to the taxpayer.

Background

38.8 Our 1994 audit examined the arrangements and co-ordination among the federal departments directly involved in delivering the federal mandate for food safety.

38.9 Health Canada has primary responsibility for health, safety and nutritional aspects of domestic and imported food. Agriculture and Agri-Food Canada and Fisheries and Oceans Canada share the food safety responsibilities with Health Canada, and further regulate the marketability of food products traded interprovincially and internationally.

38.10 The Interdepartmental Committee on Food Regulation is responsible for planning and co-ordinating the federal food safety system. The Committee responded to our Report and recommendations in 1994 (Exhibit 38.2).

It has also reviewed and concurred with the findings of this follow-up report.

Conclusion

38.11 Major organizational changes are taking place in the federal food inspection system. The new Canadian Food Inspection Agency is intended to make federal food inspection programs more efficient and effective, at a lower cost to the taxpayer. The Agency will assume the responsibility for implementing many of our recommendations, as outlined in this report.

38.12 For both domestically produced and imported food products, there has been little improvement in the consistency of safety and inspection standards and the basis on which they are applied. Although some progress has been made in developing common inspection approaches, food commodities posing similar risks to human health may still

Exhibit 38.2

Summary of 1994 Recommendations

- Interdepartmental Committee on Food Regulation to review its role and structure.
- Health Canada to review food inspection activities to:
 - make food safety standards and inspection approaches consistent;
 - eliminate inspection gaps at the federal level; and
 - acquire inspection information from the provinces.
- Departments to uniformly allocate food safety resources on the basis of risk to human health.
- Departments to co-ordinate with United States food inspection agencies in the areas of unsafe food products from third countries and foreign plant inspections.
- Departments to pursue innovation and efficiency in food safety activities; in particular, the operation of laboratories and risk-based inspection systems.
- Departments to apply the Treasury Board's user fee policy on a consistent and equitable basis.
- Departments to improve accountability in the management of the federal food safety system by:
 - conducting a program evaluation of the system's effectiveness;
 - making food-borne illness data available more quickly; and
 - improving reporting to Parliament.

Source: 1994 Report of the Auditor General of Canada

receive very different levels of safety inspection. While not compromising health and safety, this situation will persist until common standards are finalized and inspection programs are revised.

38.13 There are several areas where Health Canada has not made changes and achieved desired results as quickly as planned. For example, its audit of inspection practices at Agriculture and Agri-Food Canada and Fisheries and Oceans Canada has not fully achieved its objectives. This audit should be currently providing a critical check on the inspection activities of these departments and, soon, on the food safety activities of the new Agency.

38.14 Health Canada has made slow progress in obtaining inspection information from the provinces, in reviewing and rationalizing its laboratory facilities and in publishing data on food-borne illnesses on a more timely basis.

38.15 The federal food inspection system is in a period of great change. During this time, it will be necessary for Health Canada and the new Agency to focus increased attention on a number of areas to ensure that outstanding deficiencies are corrected, that planned economies and efficiencies are captured and that the checks and balances in the system are maintained and strengthened.

Observations

Interdepartmental Committee on Food Regulation

38.16 Restructuring the Committee. Driven by the need to reflect the restructuring of some member departments and our recommendation that it re-examine its own role and structure, the Interdepartmental Committee on Food

Regulation changed its membership and structure late in 1994. The Committee's mandate was updated, membership was shifted from deputy minister to assistant deputy minister level and the subcommittee structure was collapsed under the Interdepartmental Committee on Food Inspection.

38.17 Now, with the realignment of certain roles and responsibilities and the creation of the new food inspection agency, new structures and mechanisms may be required for effective planning and co-ordination of the federal food safety system. The mandate, structure and future role of the Committee will require review to determine whether further changes are necessary. Proper co-ordination will be important as changes are implemented.

Canadian Food Inspection Agency

38.18 The most significant achievement since the audit has been the realignment of roles and responsibilities leading to the consolidation of all federally mandated food inspection and animal and plant health programs into a single federal food inspection agency. Legislation to establish the Canadian Food Inspection Agency received first reading 19 September 1996. The Agency will report to Parliament through the Minister of Agriculture and Agri-Food Canada.

38.19 A single federal contact. The new Agency is to provide a single federal contact for consumers, industry and the provinces for food inspection policy and delivery activities. For example, importers of several different types of food products will be able to deal with one federal organization on issues related to import inspection. The creation of the Agency should also facilitate the work of the Canadian Food Inspection System initiative toward achieving harmonized food safety standards across the federal and provincial governments and more

New structures and mechanisms may be required for effective planning and co-ordination of the federal food safety system.

Departments have agreed on new health hazard risk categories for foods, based on their inherent risk to human health and that associated with their processing.

streamlined inspection delivery — in short, a more integrated national system of food inspection.

38.20 All inspection services that were provided by Agriculture and Agri-Food Canada, Health Canada and Fisheries and Oceans Canada, and related to food safety, economic fraud, trade-related requirements and animal and plant health programs, will be provided by the new Agency. The responsibility for food safety policy, standard setting, risk assessment, analytical testing research and audit of the Agency's food inspection activities will remain with Health Canada.

38.21 Increased efficiency and reduced costs. The reorganization of departments and responsibilities is to reduce costs, enhance efficiency and improve the effectiveness of inspection services. Specifically, it is to eliminate interdepartmental overlap and duplication in such areas as enforcement, risk management, laboratory services, informatics systems and communications, leading to savings of \$44 million. Combined with other savings that are planned, the cost of all federal food standard-setting and inspection efforts will fall from \$400 million in 1994-95 to roughly \$300 million when implementation is complete in 1998.

38.22 Emergency operations. Our 1994 audit found that no evaluation process existed to determine if proper actions were taken in response to food emergencies. In November 1995, Health Canada issued standard operating procedures for responding to emergency situations that called for post-emergency reviews and assessments. It has been agreed that the Agency will take the lead in responding to food safety emergencies and, as well, will be responsible for the critical post-review function. It is important that Health Canada review these

activities as part of its audit responsibilities.

38.23 Food inspection standards. Our audit recommended that specific attention be directed to making food safety standards and inspection approaches consistent. Since then, departments have agreed on new health hazard risk categories for foods, based on their inherent risk to human health and that associated with their processing. Agriculture and Agri-Food Canada has initiated a project to identify and measure the risks associated with specific food products and to then allocate its food safety inspection resources based on these risks.

38.24 The Agency will take the lead role in developing common inspection approaches and tests for food products in the three risk categories and will be responsible for applying them. Health Canada will remain responsible for establishing food safety policy and standards. These safety and inspection standards, when fully applied, will mean that foods posing similar risks, and the plants and industries producing them, will be subject to the same health and safety requirements and will receive the same level of inspection.

38.25 Progress in this area is being made, but the situation today is not much changed from 1994. Safety and inspection standards are not risk-based and consistent across products and industries, plant inspection frequencies remain inconsistent, and frequency targets are still not met.

38.26 Food import control. The interdepartmental subcommittee on imports has been working for the past two years on a number of initiatives to improve the co-ordination of food import control activities. For example, the subcommittee is identifying gaps and

duplication in existing inspection programs and will recommend ways to eliminate these situations.

38.27 The import subcommittee has found that policies concerning importer registration and licensing are inconsistent. It has also found that the responsibility for inspection of certain food commodities is unclear and that the level of inspection activity aimed at different food products may not be consistent with their potential risk to human health.

38.28 The subcommittee has confirmed that improvement in the co-ordination and consistency of import controls has been modest and much remains to be done. Departments are confident, however, that the Canadian Food Inspection Agency will have a positive impact on these and other issues, as the Agency will be the single federal contact point for importers and all federal import inspection responsibilities will rest with it.

38.29 Cost recovery. Following our observation that only a very small portion of inspection costs was recovered, the 1995 federal Budget highlighted user fee increases for food, meat and fisheries inspections. Although significant cost recovery increases have occurred — to \$19 million in 1995–96 and \$28 million (forecast) in 1996–97 — the amounts still fall far short of the cost of providing these food inspection services. In the future, the Agency will be responsible for the consistent and equitable application of cost recovery policies to food processors and distributors. It will continue to emphasize the recovery of inspection costs that provide a direct benefit to industry. The Agency's first Business Plan will outline its financial strategies and cost recovery objectives.

38.30 Co-ordination with United States food inspection agencies. Our

1994 audit included a concurrent review, conducted jointly with the United States General Accounting Office. We assessed the exchange of information between the food inspection agencies of both countries with respect to controls over food imported from third countries. We found that improved co-ordination and information sharing between Canadian and United States food agencies could lead to better inspection coverage of foreign food-processing plants and greater assurance that unsafe food is not imported into our countries.

38.31 Some action has been taken by agencies in both countries, in part as a result of trilateral discussions between Canada, the United States and Mexico. The objective of sharing information on foreign plant inspections is to both co-ordinate review activities and share inspection results between the countries. However, legal concerns related to information exchange have slowed this initiative.

38.32 Progress on the sharing of information on rejected food shipments that are subsequently re-exported to or through the United States or Canada has been achieved largely through electronic means. For example, the United States Food and Drug Administration now posts its import inspection decisions on the Internet, where they are accessible to everyone. Canadian departments are exploring similar options. We have not assessed the completeness of this information or the consistency with which it is followed up by Canadian and United States food inspection agencies.

Health Canada

38.33 The Minister of Health and the *Food and Drugs Act* have primacy in all matters relating to food health, safety and nutrition. The food safety provisions of the *Food and Drugs Act* apply to the

Although significant cost recovery increases have occurred, the amounts still fall far short of the cost of providing these food inspection services.

Health Canada's audit process has not progressed to the point where the required level of assurance can be provided to the Minister of Health.

entire Canadian food processing and distribution sector. Health Canada must maintain current and relevant standards to meet Canadian needs and see that there are reasonable enforcement strategies to safeguard the health and safety of the Canadian public.

38.34 In 1994, we concluded that Health Canada did not have all of the information needed to assess whether the food-related health and safety provisions of the *Food and Drugs Act* were applied fully and effectively to all food produced domestically or imported for sale in Canada. Gaps existed in the information received from inspection agencies — both federal and provincial — and in the coverage they achieved.

38.35 Food safety audit. Health Canada has developed a food safety audit program to provide assurance to the Minister of Health that the food safety provisions of the *Food and Drugs Act* are effectively applied. This is to be accomplished by examining all of the food inspection programs and activities of Agriculture and Agri-Food Canada and Fisheries and Oceans Canada that relate to the safety of the Canadian food supply.

38.36 Audits of various inspection activities in the two departments are currently under way. After two years, however, Health Canada cannot reach a conclusion on the food-processing industry's compliance with the food safety requirements of the *Food and Drugs Act*. The Department's audit process has not progressed to the point where the required level of assurance can be provided to the Minister of Health. This critical review of the effectiveness of federal food inspection programs must soon be directed to the activities of the Agency.

38.37 Provincial food inspection activities. In 1996, Health Canada

initiated a project to gather information on provincial and territorial food inspection activities including, for example, whether:

- compliance with standards equivalent to those of the *Food and Drugs Act* is verified;
- gaps exist in the inspection coverage of plants and imports;
- inspection approaches are consistent; and
- inspection programs are based on an assessment of risk to human health.

This project has fallen behind schedule. Health Canada is now seeking clarification on the Minister's authority to acquire such information from the provinces.

38.38 Laboratory rationalization. Agriculture and Agri-Food Canada and Fisheries and Oceans Canada have conducted individual reviews of their laboratories. Fisheries and Oceans Canada subsequently closed a number of its facilities. Health Canada plans to complete its own laboratory review by December 1996. The task will then still remain to rationalize remaining facilities across the system before the problems of overlap, duplication and overcapacity are fully resolved. The Canadian Food Inspection System initiative offers the potential for further co-ordination and streamlining of food laboratory facilities at the federal-provincial level.

Program effectiveness and accountability

38.39 Food-borne illnesses. At the time of our audit, the latest information published by Health Canada on food-borne illnesses was for 1987, a time lag of seven years. This year, summaries for 1988 and 1989 were published. Although Health Canada has recognized the timeliness of food-borne illness data to

be of paramount importance, delays in reporting this information remain unacceptably long. This information provides one indicator of the effectiveness of the food safety system. Although it could assist managers in allocating resources and managing programs more efficiently, information seven years old is of little use for these purposes.

38.40 Program evaluation. Little progress has been made in acting on our recommendation to measure the effectiveness of the Canadian food safety system by conducting a program evaluation study in co-operation with the provinces. A proposal to conduct an evaluation within the Canadian Food Inspection System initiative was put on hold pending creation of the new Agency.

38.41 Federal food safety programs have not been formally evaluated for 10 years. Information on the results and

effectiveness of changes made during this period is incomplete. An evaluation framework could now be developed based on the agreement concerning roles and responsibilities that was reached in creating the Agency. The framework could provide the basis for various evaluation projects, some of which could be designed and started right away.

38.42 Reporting to Parliament. Part III of Health Canada's Estimates now contains more and better information on the Department's food safety activities. Further improvements in the information available to members of Parliament are expected when the Canadian Food Inspection Agency produces its first Business Plan for 1997-98. Both the Agency and Health Canada have committed to developing indicators of their performance, and to measuring and then reporting their results against them.

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Agriculture and Agri-Food Canada — Farm Income Protection — 1994, Chapter 14

Assistant Auditor General: Don Young

Responsible Auditor: Doug Timmins

Background

38.43 Our 1994 chapter focussed on farm income support programs delivered by Agriculture and Agri-Food Canada. We assessed and reported the extent to which the Department had:

- designed programs with clear, consistent and commonly understood objectives to address farm income priorities;
- established systems to measure and report on their effectiveness; and
- obtained reasonable assurance that the programs were subject to proper financial management and control.

38.44 Our follow-up involved reviewing a status report on action taken. We also reviewed supporting documentation and conducted interviews to discuss and assess the extent of progress.

Conclusions

38.45 The Department has made progress in response to most of our recommendations; however, further work will be required to fully address our concerns in some areas.

38.46 Progress is lacking in some areas where it is hard to make changes to existing agreements; therefore, we can expect that progress will be minimal until new programs or agreements are in place. In other areas, agreement by the provinces and producers is needed and obtaining it will not be easy.

Observations

Programs with clear, consistent and commonly understood objectives and performance measures

38.47 In 1994, we were concerned that Agriculture and Agri-Food Canada continued to operate programs without a clear consensus on what they were expected to achieve, and thus program performance could not be measured. We concluded that the Department would have a difficult time determining whether the principles of social, environmental and production neutrality and equity as set out in the *Farm Income Protection Act* were being adhered to.

38.48 Since 1994, the Department has developed with the provinces, taking into account industry deliberations, a Framework Agreement on Agricultural Safety Nets. Four provinces have already signed the agreement, which includes a program objective statement and statements of principle on equitability, environmental sustainability, and minimization of interprovincial and intercommodity bias and trade vulnerability. The signed agreements include no principle statement on encouraging long-term social and economic stability of family farms and communities, a principle of the *Farm Income Protection Act*.

38.49 At the same time, the Department has developed a list of industry/farm-level performance indicators covering five departmental strategic goals in the areas of sustainable growth, rural opportunities, financial security, resource and

environmental sustainability, and a safe and high-quality food supply.

38.50 From this list it is not clear which performance indicators are considered relevant in relation to the recently developed program objective and principle statements. Also, no plans are in place to obtain the provinces' or farmers' acceptance of those measures to be used to monitor program results. If program performance is to be reported against expected outcomes, there is still a need to clearly set out what is to be measured, to ensure that it is commonly understood and defined, and then to collect the data.

Proper financial management and control

38.51 Up to 31 March 1994, the Saskatchewan Crop Insurance Program had received \$536 million from the federal and provincial reinsurance programs to cover a cumulative negative fund balance, even though the Program is required to be self-sustaining. Between 1991 and 1994, there was a 58 percent increase in premium revenue to address this problem, but at the same time a 20 percent decline in producer enrolment occurred. Since 1994, two studies have been commissioned to determine the causes of withdrawal. They concluded that some factor other than price had resulted in declining participation, and recommended further research. In the two years following our audit, producer participation and premium income increased. These factors helped to reduce Saskatchewan's cumulative negative fund balance. Further design changes may still be required to ensure that the Program is self-sustaining.

38.52 The federal Crop Reinsurance Program provides a means for the federal

government to share with provincial governments the financing of any large financial losses that may result from the Crop Insurance Program. The deficit in the federal reinsurance account for Saskatchewan due to such financing has been reduced from \$355 million in 1994 to \$285 million in 1996. Some progress is being made by the Department to revise the Crop Reinsurance Program in order to achieve financial self-sustainability.

38.53 In 1994, we identified a number of areas where the financial management and control of the Net Income Stabilization Account (NISA) needed to be strengthened. Reasonable progress has been made in addressing four of our five specific recommendations, while the fifth, the evaluation of the Net Income Stabilization Account Program, has just been initiated.

38.54 With the exception of our recommendation that it establish guidelines in future agreements for provincial program management and levels of service, the Department has made reasonable progress in response to the recommendations regarding deficiencies in its financial management and control.

Timely preparation and disclosure of financial statements, annual reports, and program evaluations

38.55 The Department continues to make progress in improving the timeliness of its preparation of financial statements. However, despite a commitment to the Public Accounts Committee to have evaluations of the farm income protection programs completed in 1993, 1995 and 1996, none had been completed at the time of our follow-up audit.

Atomic Energy Control Board — Canada's Nuclear Regulator — 1994, Chapter 15

Assistant Auditor General: Maria Barrados

Responsible Auditor: Ellen Shillabeer

Background

38.56 The objective of our 1994 audit was to assess whether the Atomic Energy Control Board (AECB) was fulfilling its obligations as a regulatory body. We focussed our audit on certain aspects of the AECB's regulatory program that are important to the fulfilment of its mandate.

38.57 Since we issued our Report in 1994, two major developments have been put into motion that have the potential to significantly change the operations of the AECB as well as to address our audit observations and recommendations.

38.58 First, the AECB has undertaken a major project, Project 96 and Beyond, which when implemented is expected to re-create and restructure the way it does business. In the fall of 1994, an internal review was initiated to look at the strengths and weaknesses of the organization. Subsequently, in July 1995, the President of the AECB launched Project 96. This project touched on almost all aspects of AECB's operations and involved the active participation of AECB staff at all levels of the organization. Project 96 recommendations were submitted to the President in June 1996 and are currently being considered by the President and AECB senior management for adoption and implementation.

38.59 Second, Bill C-23 was tabled in the House of Commons on 21 March 1996 to replace the *Atomic Energy Control Act* of 1946. This Bill was given second reading on 12 June 1996. At the time of writing this report, the House of

Commons Standing Committee on Natural Resources had started hearings on the Bill.

Scope

38.60 We followed up on each of our recommendations and on certain significant observations of our 1994 Report. We reviewed the AECB's August 1995 status report to the Public Accounts Committee on action taken in response to the recommendations of our 1994 Report. In June 1996, AECB officials provided us with an update to this status report as well as to certain audit observations. We discussed reported progress with them and obtained and reviewed supporting documentation.

38.61 We also assessed the extent to which the recommendations of Project 96 and Bill C-23 would address the concerns raised in our 1994 audit.

Conclusion

38.62 Recent initiatives undertaken by the AECB, most specifically Project 96, represent both a commitment to revitalize the organization and a considerable effort to address our audit concerns. These initiatives, coupled with the anticipated passage of new legislation, have the potential for providing the regulatory framework and key elements that are necessary to steer the AECB in a direction that will allow it to more fully meet its obligations as a regulatory body.

38.63 The AECB should be commended for its efforts to date and for taking steps in the right direction in responding to our audit observations and recommendations. However, much

We recognize that the AECB is facing an obvious constraint, in that resolution of more than two thirds of our audit concerns is dependent in whole or in part on the outcome of Bill C-23.

remains to be done to fully address our audit concerns and to achieve the desired results. We recognize that the AECB is facing an obvious constraint, in that resolution of more than two thirds of our audit concerns is dependent in whole or in part on the outcome of Bill C-23.

Nevertheless, the AECB needs to ensure that there is a quick disposition and implementation of relevant Project 96 recommendations and other initiatives that are currently under way and are not dependent on new legislation.

38.64 Despite the AECB's progress to date, the organization continues to be hindered in its ability to meet its regulatory obligations. In our opinion, without updated legislation and continued improvements in its management processes and practices, the AECB remains limited in its ability to fulfill its mandate.

38.65 Given the impact of Bill C-23 and of Project 96 recommendations on the AECB's progress in addressing our audit concerns, we will continue to follow up its actions and report on them at a future date.

Observations

Legislation respecting the AECB

38.66 We observed in our 1994 audit that the legislation respecting the AECB, the 1946 *Atomic Energy Control Act*, required updating. Bill C-23, as it currently reads, will provide the AECB with a more appropriate range of regulatory tools to enforce compliance with its regulations and licence conditions. The Bill also contains specific provisions allowing the AECB to require financial guarantees from licensees to ensure that there are sufficient financial resources to properly store or dispose of nuclear waste. The AECB expects that our 1994 audit

observation respecting the need for changes to its legislation will be addressed if Bill C-23 is passed. However, as noted in our 1994 audit, new legislation by itself will not correct the deficiencies identified in the management processes and practices.

Documented regulatory framework and strategic plan

38.67 There is still no clearly documented regulatory framework and strategic plan. Their development and finalization is tied, in part, to the disposition of Project 96 recommendations, and to the outcome of Bill C-23. However, the AECB has undertaken a number of initiatives that are steps in the direction toward responding to our concerns in this area. For example, it developed a new corporate documentation structure, and established a policy governing the regulatory process and a procedure for the production of consultative documents. The AECB is currently undertaking a review of all regulatory documents. Furthermore, various Project 96 tasks have examined documentation, standards and guides, philosophy of regulatory effort, scope of regulatory mandate, and long-range strategic planning.

Improvements to the compliance and enforcement function

38.68 Much remains to be done to improve the compliance and enforcement function. Nevertheless, some initiatives are under way to begin addressing our concerns in this area. For example, a general compliance and enforcement policy for the AECB has been approved, and the specific policy for radioisotope licensees has been drafted and related procedures developed. As well, approximately 50 percent of the activities outlined in the Task Analysis Project, which deals with inspection requirements

for nuclear power plants, have been implemented; additional steps have been taken to apply the AECB's regulatory policy on decommissioning in the area of uranium mining; and some improvements have been made in the follow-up of non-compliance issues related to prescribed substances and radioisotope licences. The final resolution of our audit concerns in this area is dependent, in part, on the outcome of Bill C-23 and to a lesser extent on the disposition of Project 96 recommendations. In the meantime, we encourage the AECB to continue addressing those issues not directly linked to new legislation.

Jurisdictional agreements

38.69 The AECB is continuing initiatives relating to agreements with the provinces or other federal agencies to reduce unnecessary overlap and duplication. However, these efforts are dependent on the counterpart agency agreeing to terms and conditions and on factors beyond the AECB's control. More work remains to be done to negotiate and finalize interagency agreements. Bill C-23, if passed, may also necessitate the revisiting of existing agreements to make them compatible with the new legislation.

Review of human resource requirements

38.70 The AECB has made an effort in Project 96 to address the issue of human

resource requirements. The Project includes recommendations that could potentially form the basis for determining AECB's human resource requirements in a rational manner. However, the passage of Bill C-23 and subsequent negotiations with other jurisdictions would also have an impact on the AECB's human resource requirements. In the meantime, the AECB still has not established a structured process to review on a regular basis the sufficiency of resources to fulfill its mandate.

Other initiatives and concerns

38.71 The AECB has made considerable effort to address our audit concerns regarding the program evaluation and internal audit functions. We intend to monitor these management oversight mechanisms to ensure their continued active operation.

38.72 While steps have been taken to improve the Power Reactor Staff Annual Assessment Reports, opportunities for further improvement still exist. Steps also need to be taken to improve the AECB Annual Report to provide more meaningful performance information. As indicated in our 1994 Report, information to Parliament and the public could be further improved by providing in Part III of AECB's Estimates a cross-reference to its Annual Report and to its Staff Annual Assessment Reports.

Environment Canada — Environmental Partners Fund — 1994, Chapter 19

Commissioner of the Environment and Sustainable Development: Brian Emmett

Responsible Auditor: Wayne Cluskey

Background

38.73 The Environmental Partners Fund was initiated in 1989–90 as a seven-year, \$70 million contribution program administered by Environment Canada. It was designed to fund projects that stimulated the development of local environmental initiatives and to enhance existing environmental programs. In 1991 the program became part of the Department's Environmental Citizenship Initiative.

38.74 We reviewed this program in 1994 because it represented the government's new approach to funding environmental initiatives — working with other parties who also provide services and/or funds to accomplish project objectives. This type of program has the potential to be more significant in the future as governments face increasing pressure to do more with less. It is therefore important that appropriate management structures and processes be developed for these new funding mechanisms.

38.75 We found that the projects we reviewed appeared to contribute to creating awareness of environmental issues or to resolving them, or to support the concept of sustainable development. However, we noted a number of deficiencies in the management of the program, including:

- incomplete evaluation of the program;

- inaccurate reporting of the amount of funds leveraged from participants other than the federal government;

- lack of appropriate performance indicators;

- a management information system that was not being used for a number of reasons;

- no analysis of the financial impact of in-kind contributions by other project participants on the amount of federal contributions;

- no monitoring of the total value of educational projects to ensure that the authorized cap was not exceeded; and

- no resolution of a number of management deficiencies identified in a 1991 internal audit report.

38.76 This program was scheduled to end in 1996–97 but the Department is seeking authority to extend it, with some minor modifications, as part of its Action 21 program. It has been included as part of that program since October 1995.

Conclusion

38.77 The Department is in the process of making a number of modifications to the program and has developed performance indicators to address most of the concerns raised in our 1994 Report. It is still too early to tell if these modifications and performance indicators will be sufficient for the Department to adequately control program activities and properly evaluate and report the results of the program. An evaluation of the revised program is not planned by the Department until fiscal year 1998–99.

It is still too early to tell if these modifications and performance indicators will be sufficient for the Department to adequately control program activities and properly evaluate and report the results of the program.

The Department will soon have in place the performance indicators and the management information system it needs to do a comprehensive evaluation of this contribution program.

Observations

Performance indicators

38.78 The 1991 internal audit identified a lack of appropriate performance indicators used by the program for reporting on the results being achieved. This was still true when we performed our audit in 1994. The Department has recently developed an evaluation framework for the program. From that framework, performance indicators were developed in consultation with experts in the Department. We reviewed those indicators and the Department appears to be on the right track. However, a large number of indicators are proposed and it could be difficult to aggregate them in a meaningful way for management decision making. Based on experience with these indicators, changes and improvements may be required in the future.

Management information system

38.79 Management is developing a new management information system to replace the system that was discontinued two years ago. The old system was not being used by the regions because it was difficult to use, and did not provide information that was useful to them. It did not include data on project results and could not aggregate information on project results. The new system will contain information on the projects, including performance information, to aid in management decision making and provide data for reporting results and evaluating the program. The system is being developed in consultation with the regions to ensure that it meets their needs and does not require excessive resources to enter data.

38.80 Because no common system was used by the program previously, the few statistics reported for the program

concentrated on the approved amounts. The new system should allow the Department to gather and report information on the actual results of the projects. Accurate information should then be available on such things as the amount of funds leveraged from other participants, the amount of in-kind contributions by other participants, the amount of funds spent on different types of projects and the benefits being achieved by the program. The current 1996–97 Part III of the Estimates for Environment Canada contains only a brief description of the program and the amount of funds budgeted to be spent. It contains no activity or performance information.

Program evaluation

38.81 The Department will soon have in place the performance indicators and the management information system it needs to do a comprehensive evaluation of this contribution program. Even though it has made only fairly minor changes, the Department is treating the program as new (most of the activities eligible under the old program are still eligible under the new program and the process for reviewing and approving the projects is roughly the same). Only projects approved since this program became part of the Action 21 program (October 1995) will be subject to the next program evaluation. Since the program is considered new, an evaluation cannot be done until there is sufficient activity to arrive at a proper conclusion on its operations. A departmental evaluation of this program has been scheduled for the 1998–99 fiscal year.

Operational guidelines

38.82 The Department is developing a revised set of operational guidelines for the program. The revisions pertain chiefly to the criteria for eligibility and evaluation

of projects, and to the process for reviewing and monitoring projects. The proposed changes appear to address previously identified deficiencies, but this cannot be verified until projects that have gone through the revised process are reviewed.

Organizational structure

38.83 Changes have been made to the organizational structure of the program. Delivery of the program rests with the regions. The headquarters office serves a co-ordinating function to the regions. Previously there was a headquarters organization that guided the program and administered national projects. There are no longer national projects and the

program is now the responsibility of the Director General of Communications and, on a rotational basis, one of the regional directors general. There is frequent communication between headquarters and the regions in the form of teleconferences. Projects are submitted to a departmental review committee to ensure that they are eligible and consistent among regions. Projects are approved by the regional directors general. This new structure puts more responsibility on regional management to ensure that the program is operating in accordance with its authority and guidelines. Given that these changes are quite recent, we are not in a position to comment on how well the new organizational structure is working.

Environment Canada — Ice Services — 1994, Chapter 20

Commissioner of the Environment and Sustainable Development: Brian Emmett

Responsible Auditor: Wayne Cluskey

Background

38.84 In 1994 we examined the Ice Services Program of the Atmospheric Environment Service of Environment Canada. We focussed on the Branch's strategic planning document and on the 1992 action plan developed by the Ice Services Branch in response to the recommendations of a 1991 program evaluation. It was an important period for the Ice Services Branch, which was preparing to change the way it collected and processed ice information by converting from an aircraft-based to a satellite-based system (RADARSAT), while planning and implementing its response to the government's cost-cutting requirements.

38.85 We noted the importance of defining the needs of its primary client, the Canadian Coast Guard, and those of other clients while involving them in the development and implementation of changes to ice data collection. We were concerned about the lack of a science and technology policy to clarify the national and international responsibilities of the Ice Services Branch and to provide guidance to operational managers at this difficult time. With respect to cost-cutting measures, we indicated the need to proceed cautiously in identifying commercial opportunities because of the uncertainties associated with future revenue generation.

38.86 The conversion to a satellite-based ice data collection program, made possible with the launching of RADARSAT in 1995, was expected to produce significant savings and provide the Ice Services Branch with

opportunities for revenue generation. It was particularly important, therefore, that preparations be made for unforeseen emergencies caused by partial or complete failure of RADARSAT during or immediately after launch (short term), or later during its scheduled five-year lifetime (long term).

38.87 In this respect, we found a lack of formal agreements with other agencies to provide back-up ice data collection platforms. In addition, while a contingency plan for RADARSAT failure had been developed, it had not been completely tested to assure clients of a continuation in the ice information service should a catastrophe occur.

38.88 Finally, we were concerned about the lack of an ice data archiving policy within the Ice Services Branch, given its role as one of the world's centres of ice expertise and information. In the absence of such a policy, there was no direction to fully develop the new Climatological Ice Data Archiving System into a national registry, incorporating data from both government and private sources and including databases in danger of being lost to future researchers.

Conclusion

38.89 The Ice Services Branch has taken action to address all of our observations and recommendations. However, some work remains to be done on the science and technology policy and on the formation and testing of a long-term contingency plan to ensure continuity of service should RADARSAT, now fully operational, fail at some point during its lifetime.

The Ice Services Branch has taken action on all of our observations and recommendations.

Observations

38.90 In determining the progress of the Ice Services Branch since the 1994 audit, we reviewed two status reports prepared by Environment Canada, which provided information on action taken to address our observations and recommendations. The first report was prepared in August 1995 at the request of the Public Accounts Committee of Parliament, and the second was prepared in February 1996 at our request.

38.91 We reviewed documentation supporting statements made in those reports, together with other material prepared since their completion.

Science and technology policy development

38.92 The Ice Services Branch still has no formal science and technology policy. Environment Canada indicated in its 1995 status report that a draft policy paper had been prepared and preliminary consultations with stakeholders had taken place. The Department was to finalize this document early in 1996 following further review by stakeholders.

38.93 At the time of our follow-up, the only document on file relating to a science and technology policy was a draft paper entitled "Strategic Directions for Science and Technology in Ice Services — Environment Canada" (dated 26 April 1995). This paper discusses the role of Environment Canada in understanding ice and providing information on its physical properties and distribution. It stresses the need for partnerships and provides elements of an overall management strategy. This document is over 12 months old and, according to the Department's 1996 status report, work on the development of the

science and technology policy has been suspended due to more pressing priorities.

38.94 At such a time of technological change — that is, the move to a satellite-based ice data collection system (RADARSAT) together with the Department's move to cost recovery for services and the development of revenue-generating projects — a science and technology policy would provide direction for departmental management in the development of business plans. In our view, the finalization of such a policy for the Ice Services Branch should remain a priority. It would supplement the Department's general statements in "Environment Canada's Science and Technology — Leading to Solutions", which was published earlier this year. In that document, the Department recognizes that science and technology are "Canada's keys to the new century".

Conversion to RADARSAT

38.95 RADARSAT was launched in November 1995, a few months later than originally predicted, and the Ice Services Branch began receiving images early in 1996. It formally converted to the primarily satellite-based system of ice data collection in April 1996.

38.96 In anticipation of the conversion, the Ice Services Branch developed a policy and a strategic approach to both the recovery of costs for many of its services and the commercialization of operations where feasible. Both depend on the continued provision of high-quality ice data by RADARSAT to the Ice Services Branch and its clients, at the present cost or a lower cost.

38.97 However, satellites can and do have problems, as evidenced by well-publicized failures in the last few years. Such problems are often costly to rectify and may result in loss of client

The Ice Services Branch still has no formal science and technology policy.

A long-term contingency plan has not yet been finalized and tested.

confidence and in their consideration of alternative data delivery mechanisms. Thus the development and updating of short-term and long-term contingency plans and a regular testing program for back-up systems to be used in an emergency are important considerations for a service-oriented group like the Ice Services Branch.

38.98 We note that a short-term contingency plan was prepared and tested under contract. This covered emergencies that might have occurred during the launch of RADARSAT or immediately thereafter. Thus, adequate precautions were taken for this sensitive period.

38.99 However, a long-term contingency plan being prepared by the same contractor has not yet been finalized

and tested. This plan will require third-party agreements that document administrative arrangements to supply ice data directly, to make available suitably equipped aircraft to collect data, or to provide satellite time for the use of the Ice Services Branch as needed. The completion date for the long-term contingency plan is late 1996.

38.100 In view of the difficulties experienced with satellites in the past several years, the absence of such a plan for a six-month period following start-up presents an element of risk. The plan should have been ready and tested before RADARSAT was launched, or at least by the end of its commissioning in late March 1996. It is important, therefore, that the Ice Services Branch proceed as quickly as possible to rectify the situation.

Indian and Northern Affairs Canada — Social Assistance — 1994, Chapter 23

Assistant Auditor General: Don Young

Responsible Auditor: Grant Wilson

Background

38.101 In 1994 we examined, on a selective basis, the administration by Indian and Northern Affairs Canada of its social assistance to First Nations.

38.102 We recommended that improvements be made in several areas, including the delivery of services, use of supportive legislation, initiatives to decrease dependency on social assistance, involvement of First Nations in social reforms, development of data for effective management, monitoring for compliance with social assistance requirements, and accountability.

38.103 The 1996 follow-up work included assessing the Department's reports on its progress in implementing remedial action and reviewing recent (June 1996) internal audit reports on social assistance. We did not audit the remedial action reported by the Department, nor did we attempt to identify any new issues. Those steps will be considered in our future audit plans.

Conclusion

38.104 Although the Department has reported important progress in addressing our recommendations, more work is necessary to implement them fully.

38.105 We believe that the Department needs to intensify its efforts to improve accountability for its social programs and continue its development of data for effective management. In addition, monitoring for compliance with social

assistance requirements needs to be strengthened.

38.106 Improvements are needed in these areas to help ensure that maximum benefits will be obtained for the expected substantial social assistance expenditures in the future.

Observations

38.107 In its July 1996 progress report, the Department indicated that three of the seven 1994 audit recommendations had been fully implemented. These related to the involvement of First Nations in social reform and its impact on them, the consistency of funding and delivery of services within regions, and the review and finalization of social program arrangements with certain provinces.

38.108 The remaining four recommendations were reported as partially implemented, with work continuing where applicable. These areas include co-ordination of efforts to reduce dependency, the use of legislative authority, accountability and monitoring, and development of data for management.

38.109 In addition, the Department reported the results of two internal audits of social assistance in June 1996. They covered the social assistance database and methodology for compliance.

38.110 With respect to the database, which is needed for accountability and other important purposes, the Department has reported progress under its action plan to improve the accuracy and completeness of the information it collects and uses. The improvement initiative is expected to

be completed by December 1996, although full improvements to the database may take additional time.

38.111 With respect to methodology for compliance, the Department's internal assessment was that the departmental compliance, monitoring and accountability framework was confused and weak. It did not adequately ensure that social assistance funds expended by First Nations were being used for their intended purpose as appropriated by Parliament.

38.112 Although the internal audit report on compliance methodology was released in June 1996, the Department's

conclusions were based on reviews that it conducted in February and March 1995. We were advised that considerable improvements in monitoring had been made since then. However, the Department has yet to assess the results of such improvements. The Department's action plan for changes to compliance methodology calls for their completion by April 1997.

***Department's comment:** As described in this chapter, substantial progress has been made in addressing this very complex area; we have established a detailed work plan to address the outstanding issues, and are monitoring its progress closely.*

Chapter 39

Other Audit Observations

The work that led to other audit observations was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants.

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Other Audit Observations

Main Points

39.1 The *Auditor General Act* requires the Auditor General to include in his annual Report matters of significance that, in his opinion, should be brought to the attention of the House of Commons.

39.2 The “Other Audit Observations” chapter fulfills a special role in the annual Report. Other chapters normally describe the findings of the comprehensive audits we perform in particular departments; or they report on audits and studies of issues that relate to operations of the government as a whole. This chapter reports on specific matters that have come to our attention during our financial and compliance audits of the Public Accounts of Canada, Crown corporations and other entities, or during our value-for-money audits.

39.3 The chapter normally contains observations concerning departmental expenditures and/or revenues. The issues addressed generally involve failure to comply with authorities, and the expenditure of money without due regard to economy.

39.4 Observations reported this year cover the following:

- Atomic Energy of Canada Limited needs to disclose its environmental liabilities in its financial statements.
- National Defence’s new strategic transport fleet will not fulfill all the strategic roles of the fleet it replaces, and maintaining current strategic transport capabilities is costing \$8.5 million.
- Compliance with funding conditions for the Pearson Peacekeeping Centre is lacking.
- Terms of contribution agreements do not protect the government’s interest and may contribute to low collections.

39.5 Although the individual audit observations report matters of significance, they should not be used as a basis for drawing conclusions about matters we did not examine.

Introduction

39.6 This chapter contains matters of significance that are not included elsewhere in the annual Report and that we believe should be drawn to the attention of the House of Commons. The matters reported were noted during our financial and compliance audits of the Accounts of Canada, Crown corporations and other entities, or during our value-for-money audits.

39.7 Section 7(2) of the *Auditor General Act* requires the Auditor General to call to the attention of the House of Commons any significant cases where he has observed that:

- accounts have not been faithfully and properly maintained or public money has not been fully accounted for or paid, where so required by law, into the Consolidated Revenue Fund;
- essential records have not been maintained or the rules and procedures applied have been insufficient to safeguard and control public property; to secure an effective check on the assessment, collection and proper allocation of the revenue; and to ensure that expenditures have been made only as authorized;
- money has been expended for purposes other than for which it was appropriated by Parliament;
- money has been expended without due regard to economy or efficiency; or

- satisfactory procedures have not been established to measure and report the effectiveness of programs, where such procedures could appropriately and reasonably be implemented.

39.8 Each of the matters of significance reported in this chapter was examined in accordance with generally accepted auditing standards; accordingly, our examinations included such tests and other procedures as we considered necessary in the circumstances. The matters reported should not be used as a basis for drawing conclusions about matters not examined. The instances that we have observed are described in this chapter under the appropriate department headings.

39.9 Consistent with Office policy on the follow-up of matters in our annual Report, other audit observations included in this chapter are normally followed up two years after initial reporting. In our follow-up of the observations included in our 1994 Report, we found that for three of the five observations, either corrective action had been taken to address the matter or we no longer considered the matter to be an outstanding issue. Two observations remain outstanding because they involve matters that we are continuing to monitor, and any lack of corrective action will be reported as deemed appropriate.

This chapter contains a number of observations on matters of significance not included elsewhere in the annual Report.

Atomic Energy of Canada Limited

Assistant Auditor General: Wm. F. Radburn

Responsible Auditor: John Wiersema

Atomic Energy of Canada Limited needs to disclose its environmental liabilities in its financial statements

Our recent annual Auditor's Reports on the financial statements of Atomic Energy of Canada Limited (AECL) have referred to the fact that the Corporation has not recorded its liability for decommissioning and site remediation costs. Had these costs been properly recorded in the Corporation's financial statements, the government's equity in AECL of \$464 million at 31 March 1996 would have been substantially reduced. We have reported on this matter for a number of years, but the Corporation has not yet recorded the liability for these costs. AECL needs to fulfill its obligation to disclose the cost of the Corporation's environmental liabilities to users of its financial statements.

Background

39.10 Our Report on the financial statements of Atomic Energy of Canada Limited (AECL) for the year ended 31 March 1996 (see Exhibit 39.1) was qualified for the failure to properly record significant costs associated with decommissioning the Corporation's facilities and remediating its sites (environmental liabilities). Accordingly, we were unable to provide unqualified assurance on the reliability of these financial statements to users of the statements and, in particular, to the responsible Minister, the government, members of Parliament, and the public.

Issues

39.11 Our Report also drew attention to the fact that 1996 is the fifth consecutive year that we have referred to AECL's decommissioning and site remediation costs in our annual Auditor's Report. We first drew Parliament's attention to this issue in 1992 by mentioning that there were significant decommissioning and site remediation costs facing the Corporation.

Our 1992 Report also indicated that the magnitude of these costs was such that they may place significantly increased demands on government resources. We did not qualify our opinion on AECL's financial statements in 1992. However, in each of our Reports in 1993 to 1996, we qualified our opinion on AECL's financial statements for the failure to properly record these costs. Notwithstanding five years of public reporting on this issue, AECL continues to fail to record the liability for these costs.

39.12 AECL, like other Crown corporations governed by the *Financial Administration Act*, is required to prepare financial statements in accordance with generally accepted accounting principles. These principles require that decommissioning and site remediation costs be recognized in the Corporation's financial statements in a rational and systematic manner over the estimated lives of the corresponding facilities. Therefore, in failing to properly record these costs, AECL is not providing proper accountability information to Parliament

Exhibit 39.1

AECL 1995-96 Annual
Auditor's Report**Auditor's Report****To the Minister of Natural Resources**

I have audited the consolidated balance sheet of Atomic Energy of Canada Limited as at March 31, 1996 and the consolidated statements of operations, deficit and changes in financial position for the year then ended. These financial statements are the responsibility of the corporation's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

There are significant costs associated with decommissioning the corporation's facilities and remediating its sites, including costs of residual waste storage and disposal. Generally accepted accounting principles require that these costs be recognized in a rational and systematic manner over the estimated useful lives of the corresponding facilities. However, as described in Note 10 to the financial statements, the corporation has not estimated and recorded the total liability for these costs. Accordingly, I was not able to determine the full magnitude of the adjustment that is necessary to the expenses, the liabilities and the deficit of the corporation.

In my opinion, except for the failure to record the liability for decommissioning and site remediation as described in the preceding paragraph, these consolidated financial statements present fairly, in all material respects, the financial position of the corporation as at March 31, 1996 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles. As required by the Financial Administration Act, I report that, in my opinion, these principles have been applied, after giving retroactive effect to the change in accounting policy described in Note 3 to the financial statements, on a basis consistent with that of the preceding year.

Further, in my opinion, the transactions of the corporation and of its wholly-owned subsidiaries that have come to my notice during my audit of the consolidated financial statements have, in all significant respects, been in accordance with Part X of the Financial Administration Act and regulations, the Canada Business Corporations Act and the articles and by-laws of the corporation and its wholly-owned subsidiaries.

I wish to draw your attention to the fact that, for each of the past five years, my report on the annual financial statements and transactions of the corporation has referred to the corporation's failure to record its liability for decommissioning and site remediation costs. These are significant costs of the corporation, but they have been excluded from its financial statements. The corporation refers to two reasons for not recording the liability – its view that much of the future work could not be reasonably estimated and because, historically, decommissioning activities have been financed through parliamentary appropriations. However, I do not accept these reasons because other organizations have estimated, recorded and reported these types of costs and because proper accountability reporting requires the corporation to estimate and record this liability on its financial statements, regardless of how it is to be financed. Although not a prerequisite to the proper accounting for this liability, from the Corporation's perspective, an associated issue is the respective responsibilities of the corporation and the government for funding these costs. I encourage the corporation and the government to, together, clarify this responsibility in the coming year, perhaps as part of the finalization of the funding arrangements described in Notes 7 and 10 to the financial statements.



Wm. F. Radburn, FCA
Assistant Auditor General
for the Auditor General of Canada

Ottawa, Canada
May 30, 1996

and it is not complying with a specific requirement of the *Financial Administration Act*.

39.13 We would have expected that, as a leader in Canada's nuclear industry, and as a corporation wholly owned by the Government of Canada, AECL would also be a leader in the disclosure of accountability information related to environmental liabilities.

39.14 These costs are very significant. Had they been properly recorded in AECL's financial statements, the government's equity in the Corporation of \$464 million at 31 March 1996 would have been substantially reduced.

39.15 The Corporation refers in its financial statements to two reasons for not recording these costs. As noted in our Auditor's Report, we do not accept these reasons. AECL's first reason is its view that much of the future work could not be reasonably estimated. However, other organizations, notably Canadian utilities that employ nuclear power reactors, have been able to develop an estimate of similar costs in their circumstances, and to properly record and disclose them. In our view, AECL has had ample time to estimate and disclose these costs.

39.16 AECL's second reason for not recording these costs is that, historically, decommissioning activities have been financed through parliamentary appropriations. However, in our view, proper accountability reporting requires the Corporation to estimate and record these costs, regardless of how they are to be financed. Indeed, the possibility that these costs might be financed by appropriation lends more weight to the importance of estimating and disclosing the liability so that the government and Parliament are informed of the magnitude

of the possible demand on public resources.

39.17 The respective responsibilities of the government and the Corporation for funding these costs have been the subject of discussions between AECL and government officials for many years. We understand that, from the Corporation's perspective, the responsibilities for funding these costs and proper accounting for them are related issues. As disclosed in AECL's 1996 financial statements, the Corporation is of the view that there has been some progress, in 1995-96, in the discussions on financing a portion of these costs. Although not a prerequisite to proper accounting, we encourage the Corporation and the government to clarify, in the coming year, the responsibilities for funding these costs.

Conclusion

39.18 AECL needs to fulfill its obligation to disclose the cost of the Corporation's environmental liabilities to users of its financial statements.

***Corporation's response:** There is no issue between the Auditor General and AECL over the need to record properly site remediation and/or decommissioning liabilities that fall to the Corporation. The issues are over the reasonable estimation of those costs and funding mechanisms for them.*

On the first point, over the past decade the government and AECL have been addressing, on an ongoing basis, the remediation of nuclear sites owned and operated by the Corporation in line with AECB regulations and sound management practices. This has been accomplished through a government funding process. As a fundamental part of the development of the Canadian nuclear industry, the Corporation has acquired and operated a variety of nuclear facilities for use in both research and the supply of isotopes for

medical use. As well, its sites have been the depository of radioactive wastes on behalf of the government and the medical industry. The variety of these wastes, not all of AECL's making, goes to the heart of the Corporation's view that there are difficulties in making reasonable estimates of all future work required. It is the complexity of such an estimation that distinguishes AECL's situation from that of other entities like Canadian utilities, the nature of whose waste is much more straightforward and therefore predictable.

This question is also inextricably linked to funding responsibilities and funding sources, which raises the second question. Historically the government has accepted responsibility for funding decommissioning or remediation work and AECL believes that this represents the proper locus of the liability, although AECL carries out work on the Crown's behalf. Discussions continue to be held with our shareholder concerning this issue, with a view to finding a resolution to the matter.

AECL's management feels therefore that any decision to irrevocably book the liability must be made in the broader context of the government's total liability for environmental costs. Therefore, it would not be appropriate for AECL to unilaterally accept the Auditor General's proposed accounting treatment without the blessing of the Crown. By the very nature of being an agency of the Crown, any recognition of the liability by AECL simply flows to the books of Canada, through the consolidation of the Crown's equity in AECL.

In short, the government's position is a critical factor in the resolution of the issue. As it becomes clearly articulated, the correct accounting treatment becomes clear. Such a solution is being actively sought. Notes in AECL's annual financial statements highlight the issue and have done so for several years. However, the Corporation believes the framework policy of the government and the needs of safety, health and those of an environmental nature must be fully satisfied, not just the accounting needs.

National Defence

Assistant Auditor General: David Ratray

Responsible Auditor: Peter Kasurak

Following government direction to purchase aircraft, National Defence's new strategic transport fleet will not fulfill all the strategic roles of the fleet it replaces, and maintaining current strategic transport capabilities until April 1997 is costing the Department \$8.5 million

Following the government's direction in 1992, National Defence bought five A310 Airbus aircraft, from existing funds, as replacements for the Boeing 707 strategic transport fleet. Prior to receiving this direction, the Department had no plans to replace the fleet before 1999. It saw this purchase as an opportunity to replace aging aircraft.

Retaining two 707s in the fleet until April 1997 to provide needed strategic transport capabilities is costing the Department \$8.5 million. After modifications are completed in December 1997, the five A310 aircraft will be able to transport troops and cargo but not carry out air-to-air refuelling. This strategic requirement will be partly met in the interim by tactical air-to-air refuelling aircraft.

Background

39.19 In 1992, National Defence purchased three A310 Airbus aircraft from a Canadian airline, on the direction of the government. Treasury Board ministers approved the allocation of \$499 million of the Department's funds toward this purchase and the purchase of two additional A310s to replace five Boeing 707s making up the strategic transport fleet. Currently, the Department estimates it will spend \$440 million.

39.20 Before this purchase, National Defence had determined that the Boeing fleet would reach the end of its estimated life expectancy by 1996. The Department was reviewing options for either replacing or refitting the planes and extending them to 1999. In February 1992, the Vice-Chief of the Defence Staff advised senior departmental officials that it was imperative that the list of capital projects being considered for submission by the Deputy Minister/Chief of the Defence

Staff to the Minister of National Defence be "essential to the core of and consistent with the Defence Policy, affordable, saleable and also have maximum utility for the Canadian Forces."

39.21 Government direction superseded the Department's normal internal process of reviewing alternatives and recommending an affordable course of action. Before being given authority by the Treasury Board to replace the Boeing fleet, the Department had not identified replacement aircraft as affordable or as a priority. In June 1992, the Department advised the government that it could not afford to replace the Boeing 707 fleet. The Boeing fleet was to be replaced in 1999 when the Department expected funds to be available. However, to take advantage of this opportunity, in August 1992 the Department agreed to change its priorities to obtain five aircraft as replacements for the aging Boeing fleet, ahead of the planned replacement schedule. In order to finance this project, National Defence

reallocated funds from other defence projects and moved funds from National Procurement to Capital.

39.22 National Defence paid \$265 million to three aviation industry firms for five used A310 passenger-configured planes. The Department paid an additional \$12 million for modifications. This included the installation of operational equipment, reconfigurations to the interior section and painting of each plane, and fitting one A310 with an Executive Interior for VIP transport. The government required that the fleet be capable of transporting dignitaries with a “head-of-state” status.

39.23 By January 1994, the Department had received all five Airbus passenger aircraft and had entered them into service along with three remaining Boeing 707s yet to be retired. In total, National Defence paid \$277 million for five A310s capable of military passenger and VIP transport. A further \$81 million, including GST, will be spent on modifications enabling the planes to convert to cargo carriers. Once completed, this \$358 million plus other project costs will bring the total to about \$440 million.

Issues

39.24 The \$81 million cargo conversion contract was awarded without competition. In October 1992, the Minister for Supply and Services advised a company that he would let a sole-source contract to the company for cargo modifications to four planes in the Airbus fleet. The Minister noted the company’s “extensive business relationships with the Airbus Consortium” and its established Agreement-in-Principle to work with one Airbus partner. The Minister stated in his letter to the company that, in light of these noted relationships, the sole-source contract was

essential to reduce the risks to the Crown. Ultimately, the Minister expected to enter into negotiations with the company to contract the modification work, subject to successful negotiations.

39.25 Beginning in October 1992, National Defence and Public Works and Government Services Canada worked with the contractor on defining the cargo modifications for a contract. National Defence developed technical specifications and expected that the cargo modifications would be subcontracted to the Airbus partner referred to in the Minister’s letter. A Request for Proposal was issued on a sole-source basis in November 1993 and a proposal was received from the contractor in May 1994.

39.26 Initially, one plane was to be modified in Europe as a prototype and the remaining three in Canada. However, the contractor stated in May 1994 that the cost of this option was “exorbitantly high” and recommended that an alternative, less expensive approach be sought. The Department therefore reviewed other options, which included following its own procurement strategy without the involvement of the contractor. The Department determined that the modifications would continue to be sourced through the contractor. A request for a revised proposal, changing the contract to have all work done in Europe, was issued on a sole-source basis in October 1994.

39.27 The contractor accepted bids from the Airbus partner referred to in the Minister’s letter and from a second firm. The second firm offered the least-cost option and, in January 1995, was chosen by the contractor to do the cargo modifications. National Defence questioned the contractor’s technical assessment and, in order to address the Department’s concerns that technical

Seven aircraft are being used to accomplish a role previously fulfilled by five.

specifications were not being met, the contractor returned to its subcontractor for clarification and confirmation of compliance.

39.28 In June 1995, a contract was signed for \$81 million, which includes \$8.6 million in project management fees to the contractor and \$5.3 million for GST. In February 1996, the first A310 arrived in Europe for cargo modification work. Modifications to all four planes are scheduled for completion by the end of December 1997.

39.29 The cargo conversion is delayed by almost two years. Initially, receipt of a cargo-modified A310 fleet was to coincide with the retirement of the five Boeings. Although some overlap was planned, the Department had expected to be flying only the Airbus by the time the Boeings approached the end of their estimated life expectancy in 1996. The preliminary discussions and negotiations for a cargo modification contract lasted almost two years longer than initially planned and delayed delivery of a cargo/passenger-combination capable aircraft by 18 to 24 months. The Department will not have four cargo-modified aircraft to coincide with the originally anticipated 1996 Boeing retirement date.

39.30 The five A310s will not have the same capability as the planes they replace. The Department's submission to the Treasury Board for approval to purchase five A310s outlined the four roles expected of the strategic transport fleet: strategic airlift of personnel, strategic airlift of freight, VIP transport and air-to-air refuelling. The Department decided that A310 strategic air-to-air refuelling, though highly desirable, could be excluded from approval in its Treasury Board submission as it was acquiring five Hercules aircraft with shorter-range tactical air-to-air refuelling capability. The

longer-range strategic air-to-air refuelling was therefore not included in the final funding approval for the A310s. National Defence explained in its submission that a new project would be instigated when strategic air-to-air refuelling was reclassified to "essential". It began this project in May 1993. In the A310 Master Implementation Plan, the Department stated, "The [Airbus] is planned to be modified to be air-to-air refuelling capable." However, lack of funds has resulted in postponing any decision on this project, which would require roughly \$80 million in additional funding. Upon completion of the Airbus modifications in December 1997, National Defence will have the capability to fulfill only three of the four strategic transport roles.

39.31 The strategic transport fleet is currently using seven aircraft to accomplish a role previously fulfilled by five aircraft. At present, the Department's Airbus fleet can provide only passenger transport and has limited cargo space. In order to remain ready to fulfill its commitments, National Defence has kept two Boeing 707s to overcome deficiencies in the Airbus fleet. These two planes are retained for cargo transport and strategic air-to-air refuelling support to the CF-18 fighter aircraft. The Department currently is maintaining seven aircraft in its fleet for a role that previously required only five. It plans to retire the remaining Boeings by April 1997.

39.32 National Defence is incurring \$8.5 million in costs to maintain its strategic transport capability. The Department estimates that \$8.5 million in costs incurred are a result of maintaining two Boeing 707 aircraft in the fleet beyond their expected June 1996 retirement date. The 707s are being used for cargo and strategic air-to-air refuelling not provided by the five A310s.

Conclusion

39.33 Retaining the capabilities provided by the previous Boeing 707 strategic transport fleet, not fully provided by the A310 fleet, is costing the Department an estimated \$8.5 million to April 1997. After December 1997, the A310 aircraft will be able to transport troops and cargo but not carry out air-to-air refuelling. This strategic requirement will be partly met in the interim by tactical air-to-air refuelling aircraft.

Department's response: *The A310 Airbus was not intended to fulfill all the roles of*

the Boeing strategic transport fleet. The acquisition of five Hercules aircraft, with shorter-range tactical air-to-air refuelling capability, allowed the Department to defer a decision on how best to satisfy our longer-range air-to-air refuelling capability. Two Boeing 707s were extended to provide limited strategic air-to-air capabilities in the interim. This meant they were also available for carrying cargo. The \$8.5 million expenditure is attributable to the decision to continue the operation of the Boeing 707 fleet beyond its original date, thereby providing the Department with the opportunity to consider options to address our strategic air-to-air refuelling capability.

National Defence and Foreign Affairs and International Trade

Assistant Auditor General: David Rattray

Responsible auditors: John Hutchinson and Peter Kasurak

Lack of compliance with funding conditions for Pearson Peacekeeping Centre

The departments of National Defence and Foreign Affairs and International Trade have not complied with all terms and conditions of Treasury Board approval of funding for the Pearson Peacekeeping Centre. They have not ensured that the Centre has a workable business plan. The financial viability of the Centre is in jeopardy.

Background

39.34 In February 1994, the government announced the establishment of the Pearson Peacekeeping Centre for peacekeeping training, on the site of the former CFB Cornwallis in Nova Scotia. In August 1994, the Treasury Board authorized a contribution to the Canadian Institute of Strategic Studies (CISS) to establish and manage the Canadian International Peacekeeping Training Centre (named the Pearson Peacekeeping Centre). National Defence and Foreign Affairs would each contribute \$5 million to CISS for the Centre during the five-year period ending March 1999. The broad objectives of the Centre were to provide research, education and practical training related to peacekeeping. Those objectives did not include conducting the military training required by Canadian Forces personnel assigned to peacekeeping duties. The Centre was to seek out clients among other countries, non-governmental organizations and police agencies. The Treasury Board required CISS to show that the Centre could be financially self-sufficient by 1999–2000.

39.35 The Centre was established in support of both the foreign and defence policies. Both departments agreed with the concept of the Centre as well as with the

financial contributions from their respective departments.

Issues

39.36 The Treasury Board required that the two departments not approve payment of their departmental shares of the initial start-up contribution until they were jointly satisfied that the Canadian Institute for Strategic Studies had a business plan for the Centre that had a reasonable prospect for success.

39.37 In October 1994, the Institute submitted a five-year business plan to National Defence and Foreign Affairs. We could find no indication that either department had analyzed the plan in sufficient depth to determine whether it was workable, as required by the terms and conditions of the Treasury Board approval. Nevertheless, initial funding totalling \$3 million was disbursed in 1994–95.

39.38 The 1994 business plan soon proved to be unrealizable. The Centre encountered significant unforeseen start-up expenses. In the initial stages, it seriously underspent on such items as library and audio-visual aids, due to high unforeseen costs for items such as furniture, office equipment and vehicles. As well, the Centre could not reach a

rental agreement with the Cornwallis Park Development Association (CPDA), as called for in its 1994 business plan. To the end of our audit in September 1996, there was still no resolution between the two parties and the Centre still had not paid rent. The Centre incurred additional unforeseen costs when the CPDA made tenants responsible for their own utilities. The Centre installed stand-alone boilers at a cost of over \$500,000.

39.39 In March 1995, the Canadian Institute for Strategic Studies submitted a new business plan for the Centre for 1995–96. National Defence and Foreign Affairs reviewed the plan and informed the Centre that it was inadequate. Among other reasons, it did not identify future marketing strategies to ensure the Centre's success in recovering operating costs from tuition fees. The Treasury Board approval called for the departments to reduce or terminate their contributions if the Institute and the Centre were not complying with the terms and conditions of the approval. An important condition was that they develop a workable business plan.

39.40 National Defence conducted a program evaluation of the Centre in the fall of 1995. Foreign Affairs managers were also monitoring the situation. The National Defence evaluation concluded that the Centre did not have a viable business plan, and would not be self-sufficient in the foreseeable future. After March 1999, the Centre would require as much as \$1.4 million per year in federal subsidies to continue operations. To the end of our audit, the Centre still did not have a viable business plan. Nevertheless, both departments continue to provide funding because of the Centre's potential to meet their policy and training goals. To the end of our audit, they had contributed a total of \$6.3 million. The

evaluation also noted that the UN had identified 18 peacekeeping training facilities, but that none is required to be self-sufficient in the manner of the Pearson Peacekeeping Centre.

39.41 The Treasury Board approval also required both departments, at the end of each fiscal year, to report to their respective deputy ministers on the conduct, management and achievements of the Centre, and the outlook for the forthcoming fiscal year. To date, neither department has adequately fulfilled this requirement. However, in early 1996, National Defence staff apprised the Deputy Minister of the results of the program evaluation. In Foreign Affairs, an assistant deputy minister was involved in monitoring the Centre's programs.

39.42 The National Defence program evaluation noted that there is almost no background information on the rationale used to determine the federal government's financial contribution of \$10 million to the Centre. National Defence supported the Centre by providing the majority of course participants and by funding over 85 percent of the Centre's students, but did not identify specific training objectives for Canadian Forces attendees. At various times, National Defence and Foreign Affairs both expressed concern to the Centre that it was not attracting enough students from other sectors involved in peacekeeping. In 1996 National Defence conducted a study on peacekeeping training that considered the potential role of the Centre. It identified 5 out of 13 areas where the Centre could potentially provide peacekeeping training. If National Defence selects the Centre to provide this training, it will have to identify sources of departmental funding. To the end of our audit, Foreign Affairs had sent only two students.

To the end of our audit, the Centre still did not have a viable business plan.

Conclusion

39.43 The Centre has depended heavily on the financial contributions from National Defence and Foreign Affairs. It also continues to depend on National Defence for the provision and funding of course participants. The operation of the Centre will most likely continue to require considerable support from the federal government, and current levels of funding may be insufficient. Although National Defence and Foreign Affairs have recently begun to fulfill many of their oversight responsibilities concerning the Centre, both departments are still failing to comply fully with the Treasury Board terms and conditions for approval of the funding. National Defence and Foreign Affairs need to make a business case decision that addresses the issue of viability and of whether to continue or discontinue funding to the Centre. The case needs to be resubmitted to the Treasury Board for approval.

***Departments' joint response:** The Department of Foreign Affairs and International Trade and the Department of National Defence believe they have largely met the conditions set by the Treasury Board. Where there may have been lack of compliance, it was as a result of our wishing to support the tremendous pace with which the Pearson Peacekeeping Centre (PPC) set out to implement its mandate within its first two years of operation. The PPC was therefore able to train 251 foreign officers from 57 countries in critical peacekeeping functions.*

The results of these efforts must be recognized. By developing and implementing the New Peacekeeping Partnership, the PPC has provided a unique approach to peacekeeping research, education and training, unmatched by the approximately 30 other peacekeeping training centres worldwide.

There is also no precedent in Canada for the establishment of a peacekeeping training centre. Decisions concerning initial funding levels, infrastructure requirements and curriculum development were made without benefit of historical data. For example, the additional unforeseen infrastructure start-up costs were of such a magnitude that they seriously distorted the initial business plan. It should also be noted that in accordance with the Treasury Board submission, the general supervision of the PPC (e.g. the responsibility for the development of a workable business plan) rested with the Canadian Institute of Strategic Studies.

At the time of this audit, it was recognized by Foreign Affairs and International Trade and National Defence that there was not yet a business plan that would enable the PPC to attain self-sufficiency by the end of the contribution agreement. Therefore both departments decided to initiate an independent review of the PPC to examine its financial management, administration and operational procedures. On completion of the review, the departments will convene a meeting to determine the future financial viability of the PPC. The departments will then consider initiating a Treasury Board submission so that they can fully exercise their oversight responsibility and seek additional funds if so determined.

Western Economic Diversification Canada

Assistant Auditor General: Don Young

Responsible Auditor: Roger Simpson

Terms of contribution agreements for three large projects do not protect the government's interests and may contribute to expected low collections of conditionally repayable financial assistance

Western Economic Diversification Canada provides, among other things, conditionally repayable financial assistance under contribution agreements. Poorly designed terms in three agreements do not adequately protect the government's interests, and may contribute to the Department's expected low collections.

Background

39.44 Since 1987, the Western Diversification Program of Western Economic Diversification Canada has approved some \$84 million of conditionally repayable financial assistance. Conditionally repayable assistance becomes repayable when certain predetermined events occur, such as the recipient's achieving a specified level of sales or equity. Repayments, as long as they are not in arrears, are without interest.

39.45 Since 1995-96, the Department has had an arrangement with the Treasury Board that a portion of its annual appropriations will be based on revenues it collects. The Department will need to collect repayments in order to finance its future programs.

Issues

39.46 The Department recently began assessing repayment potential on a five-point scale with 1 the highest and 5 the lowest. On this scale, when averaged by dollars, the Department's overall assessment of its conditionally repayable assistance is 4.1. The Department forecasts that about 36 percent of the

approved conditionally repayable assistance will ultimately be repaid.

39.47 These agreements can be complex. We would expect that they would contain a clear statement of intent between the parties, and that repayment terms would be structured in such a way that a recipient's financial success would lead to repayment.

39.48 When providing conditionally repayable assistance, linking success and repayments can be complicated, and a recent departmental analysis of one of its many conditionally repayable projects notes, "Experience has shown that trying to tie repayment to anything other than gross revenues does not work... it is an unambiguous figure, and not easily manipulated by any party...[the recipients are] no doubt aware of the vehicles available to them under the current repayment clause to avoid repayment." Three steps necessary for achieving this link are summarized in Exhibit 39.2.

39.49 We reviewed three large projects that together represent \$26 million or 31 percent of total conditionally repayable assistance to ascertain what contributed to the Department's expectation of low collections and high risk.

39.50 Our review of the cases revealed that repayment triggers and contractual conditions do not establish unambiguous conditions for repayment in order to protect the government's interests. Exhibit 39.3 provides an example.

Conclusion

39.51 Poorly designed terms in contribution agreements for conditionally repayable financial assistance do not adequately protect the government's interests, and may contribute to expected low repayments.

***Department's response:** It is the position of Western Diversification (WD) that the audit does not present a complete picture of the project or the use by WD of conditional repayments. In particular, it fails to acknowledge that the project described in Exhibit 39.3 has been highly successful in terms of economic diversification through the creation of a world-class research and development facility in Western Canada, the development and transfer of new*

technologies in partnership with government and academic research institutions, and the creation of highly skilled jobs. This would not have occurred without assistance from governments.

The project described in the exhibit was a three-way partnership between the federal government, the provincial government, and a private sector company to undertake a high-risk initiative in leading-edge areas of technology.

The total federal contribution was \$30 million and the provincial contribution was \$40 million. The investment by the private partner to date exceeds \$70 million. Because of the significant potential benefits of the project, and the desire of the federal and provincial partners to encourage long-term reinvestment in research and development and financial self-sufficiency of the facility, a repayment structure was chosen that would require repayment should retained earnings exceed the amount agreed to by the partners to maintain the facility as a self-funded research and development facility.

Exhibit 39.2

Three Requirements Necessary to Link Success with Repayments

Requirement necessary to link a recipient's success and repayments to the government	Issues
1. Condition that triggers repayment must link to financial success.	Care must be taken to ensure that the condition selected to trigger repayments (for example, achievement of a certain level of sales) is related to success.
2. Conditions in agreement must ensure that the recipient cannot structure its financial affairs to avoid repayment.	Conditions must ensure that the recipient cannot avoid repayment. For example, if repayments are triggered based on sales, agreement should prohibit the recipient from: <ul style="list-style-type: none"> • recording sales in a related company not included in the agreement; or • making sales to a related company at prices lower than market price.
3. Department must monitor project to ensure that the recipient complies with the terms and makes repayments when due.	The repayment trigger must be monitored.

Prior to the adoption of conditionally repayable contributions by WD as an innovative way to include the potential for repayment in high-risk projects, federal funding for these projects was typically non-repayable. In general, WD's agreements, which include the provision for repayment, contain several clauses designed to protect the government's

investment. These clauses provide for the recovery of all or part of the government's assistance in the event of a project default for reasons such as abandoning the project, the sale or transfer of the supported assets, the failure to provide adequate financial information, and the breach of repayment conditions.

In 1990, as part of an agreement between several parties, the Department approved \$15 million of assistance to a group of companies to develop products. The Department's assistance was later increased to \$20 million. Repayment is to be triggered when a designated company in the group has retained earnings in excess of \$20 million. Retained earnings are one component of a shareholder's equity and are essentially profits to date, less losses and dividends to date.

Imprecise wording of the agreement may allow the group of companies to gain financial success from the products that the Department's contribution helped to develop, and without repayment being triggered, because:

- the agreement does not require that products developed by related companies lead to revenues in the designated company in which \$20 million of retained earnings would trigger repayments; and
- the agreement does not prohibit the designated company from keeping its retained earnings below \$20 million by paying dividends to shareholders.

Exhibit 39.3

Example of a Conditionally Repayable Project

Appendices

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APPENDIX A

AUDITOR GENERAL ACT

R.S.C., c. A-17

An Act respecting the office of the Auditor General of Canada and sustainable development monitoring and reporting.

1995, c. 43, s.1.

SHORT TITLE

Short title	1. This Act may be cited as the <i>Auditor General Act</i> . 1976-77, c. 34, s.1.
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INTERPRETATION

Definitions 2. In this Act,

“appropriate Minister” has the meaning assigned by section 2 of the *Financial Administration Act*;

“Auditor General” “Auditor General” means the Auditor General of Canada appointed pursuant to subsection 3(1);

“category I department” means

- (a) any department named in Schedule I to the *Financial Administration Act*,
- (b) any department in respect of which a direction has been made under subsection 24(3), and
- (c) any department, as defined in the *Financial Administration Act*, set out in the schedule;

“Commissioner” means the Commissioner of the Environment and Sustainable Development appointed under subsection 15.1(1);

“Crown corporation” has the meaning assigned to that expression by section 83 of the *Financial Administration Act*;

“department” “department” has the meaning assigned to that term by section 2 of the *Financial Administration Act*;

“registrar” means the Bank of Canada and a registrar appointed under Part IV of the *Financial Administration Act*;

“sustainable development” means development that meets the needs of the present without compromising the ability of future generations to meet their own needs;

“sustainable development strategy” “sustainable development strategy”, with respect to a category I department, means the department’s objectives, and plans of action, to further sustainable development. 1976-77, c. 34, s. 2; 1984, c. 31, s. 14; 1995, c. 43, s. 2.

AUDITOR GENERAL OF CANADA

Appointment and tenure of office

3. (1) The Governor in Council shall, by commission under the Great Seal, appoint a qualified auditor to be the officer called the Auditor General of Canada to hold office during good behaviour for a term of ten years, but the Auditor General may be removed by the Governor in Council on address of the Senate and House of Commons.

Idem	(2) Notwithstanding subsection (1), the Auditor General ceases to hold office on attaining the age of sixty-five years.
Re-appointment	(3) Once having served as the Auditor General, a person is not eligible for re-appointment to that office.
Vacancy	(4) In the event of the absence or incapacity of the Auditor General or if the office of Auditor General is vacant, the Governor in Council may appoint a person temporarily to perform the duties of Auditor General. 1976-77, c. 34, s. 3.
Salary	4. (1) The Auditor General shall be paid a salary equal to the salary of a puisne judge of the Supreme Court of Canada.
Pension benefits	(2) The provisions of the <i>Public Service Superannuation Act</i> , other than those relating to tenure of office, apply to the Auditor General except that a person appointed as Auditor General from outside the Public Service may, by notice in writing given to the President of the Treasury Board not more than sixty days after the date of his appointment as Auditor General, elect to participate in the pension plan provided for in the <i>Diplomatic Service (Special) Superannuation Act</i> in which case the provisions of that Act, other than those relating to tenure of office, apply to him and the provisions of the <i>Public Service Superannuation Act</i> do not apply to him. 1976-77, c. 34, s. 4; 1980-81-82-83, c. 50, s. 23, c. 55, s. 1.

DUTIES

Examination	5. The Auditor General is the auditor of the accounts of Canada, including those relating to the Consolidated Revenue Fund and as such shall make such examinations and inquiries as he considers necessary to enable him to report as required by this Act. 1976-77, c. 34, s. 5.
Idem	6. The Auditor General shall examine the several financial statements required by section 64 of the <i>Financial Administration Act</i> to be included in the Public Accounts, and any other statement that the President of the Treasury Board or the Minister of Finance may present for audit and shall express his opinion as to whether they present fairly information in accordance with stated accounting policies of the federal government and on a basis consistent with that of the preceding year together with any reservations he may have. 1976-77, c. 34, s. 6; 1980-81-82-83, c. 170, s. 25.
Annual and additional reports to the House of Commons	7. (1) The Auditor General shall report annually to the House of Commons and may make, in addition to any special report made under subsection 8(1) or 19(2) and the Commissioner's report under subsection 23(2), not more than three additional reports in any year to the House of Commons <ul style="list-style-type: none"> (a) on the work of his office; and, (b) on whether, in carrying on the work of his office, he received all the information and explanations he required.
Idem	(2) Each report of the Auditor General under subsection (1) shall call attention to anything that he considers to be of significance and of a nature that should be brought to the attention of the House of Commons, including any cases in which he has observed that <ul style="list-style-type: none"> (a) accounts have not been faithfully and properly maintained or public money has not been fully accounted for or paid, where so required by law, into the Consolidated Revenue Fund;

- (b) essential records have not been maintained or the rules and procedures applied have been insufficient to safeguard and control public property, to secure an effective check on the assessment, collection and proper allocation of the revenue and to ensure that expenditures have been made only as authorized;
- (c) money has been expended other than for purposes for which it was appropriated by Parliament;
- (d) money has been expended without due regard to economy or efficiency;
- (e) satisfactory procedures have not been established to measure and report the effectiveness of programs, where such procedures could appropriately and reasonably be implemented; or
- (f) money has been expended without due regard to the environmental effects of those expenditures in the context of sustainable development.

**Submission of
annual report to
Speaker and tabling
in the House of
Commons**

(3) Each annual report by the Auditor General to the House of Commons shall be submitted to the Speaker of the House of Commons on or before December 31 in the year to which the report relates and the Speaker of the House of Commons shall lay each such report before the House of Commons forthwith after receiving it or, if that House is not then sitting, on any of the first fifteen days on which that House is sitting after the Speaker receives it.

**Notice of additional
reports to Speaker
and tabling in the
House of Commons**

(4) Where the Auditor General proposes to make an additional report under subsection (1), the Auditor General shall send written notice to the Speaker of the House of Commons of the subject-matter of the proposed report.

**Submission of
additional reports to
Speaker and tabling
in the House of
Commons**

(5) Each additional report of the Auditor General to the House of Commons made under subsection (1) shall be submitted to the House of Commons on the expiration of thirty days after the notice is sent pursuant to subsection (4) or any longer period that is specified in the notice and the Speaker of the House of Commons shall lay each such report before the House of Commons forthwith after receiving it or, if that House is not then sitting, on any of the first fifteen days on which that House is sitting after the Speaker receives it. 1976-77, c. 34, s. 7; 1994, c. 32, s. 1 and 2; 1995, c. 43, s. 3.

**Special report to the
House of Commons**

8. (1) The Auditor General may make a special report to the House of Commons on any matter of pressing importance or urgency that, in the opinion of the Auditor General, should not be deferred until the presentation of the next report under subsection 7(1).

**Submission of
reports to Speaker
and tabling in the
House of Commons**

(2) Each special report of the Auditor General to the House of Commons made under subsection (1) or 19(2) shall be submitted to the Speaker of the House of Commons and shall be laid before the House of Commons by the Speaker of the House of Commons forthwith after receipt thereof by him, or if that House is not then sitting, on the first day next thereafter that the House of Commons is sitting. 1976-77, c. 34, s. 8; 1994, c. 32, s. 3.

Idem

9. The Auditor General shall

- (a) make such examination of the accounts and records of each registrar as he deems necessary, and such other examinations of a registrar's transactions as the Minister of Finance may require, and
- (b) when and to the extent required by the Minister of Finance, participate in the destruction of any redeemed or cancelled securities or unissued reserves of securities authorized to be destroyed under the *Financial Administration Act*,

and he may, by arrangement with a registrar, maintain custody and control, jointly with that registrar, of cancelled and unissued securities. 1976-77, c. 34, s. 9.

Improper retention
of public money

10. Whenever it appears to the Auditor General that any public money has been improperly retained by any person, he shall forthwith report the circumstances of the case to the President of the Treasury Board. 1976-77, c. 34, s.10.

Inquiry and report

11. The Auditor General may, if in his opinion such an assignment does not interfere with his primary responsibilities, whenever the Governor in Council so requests, inquire into and report on any matter relating to the financial affairs of Canada or to public property or inquire into and report on any person or organization that has received financial aid from the Government of Canada or in respect of which financial aid from the Government of Canada is sought. 1976-77, c. 34, s. 11.

Advisory powers

12. The Auditor General may advise appropriate officers and employees in the public service of Canada of matters discovered in his examinations and, in particular, may draw any such matter to the attention of officers and employees engaged in the conduct of the business of the Treasury Board. 1976-77, c. 34, s. 12.

ACCESS TO INFORMATION

Access to
information

13. (1) Except as provided by any other Act of Parliament that expressly refers to this subsection, the Auditor General is entitled to free access at all convenient times to information that relates to the fulfilment of his responsibilities and he is also entitled to require and receive from members of the public service of Canada such information, reports and explanations as he deems necessary for that purpose.

Stationing of
officers in
departments

(2) In order to carry out his duties more effectively, the Auditor General may station in any department any person employed in his office, and the department shall provide the necessary office accommodation for any person so stationed.

Oath of secrecy

(3) The Auditor General shall require every person employed in his office who is to examine the accounts of a department or of a Crown corporation pursuant to this Act to comply with any security requirements applicable to, and to take any oath of secrecy required to be taken by, persons employed in that department or Crown corporation.

Inquiries

(4) The Auditor General may examine any person on oath on any matter pertaining to any account subject to audit by him and for the purposes of any such examination the Auditor General may exercise all the powers of a commissioner under Part I of the *Inquiries Act*. 1976-77, c. 34, s.13.

Reliance on audit
reports of Crown
corporations

14. (1) Notwithstanding subsections (2) and (3), in order to fulfil his responsibilities as the auditor of the accounts of Canada, the Auditor General may rely on the report of the duly appointed auditor of a Crown corporation or of any subsidiary of a Crown corporation.

Auditor General
may request
information

(2) The Auditor General may request a Crown corporation to obtain and furnish to him such information and explanations from its present or former directors, officers, employees, agents and auditors or those of any of its subsidiaries as are, in his opinion, necessary to enable him to fulfil his responsibilities as the auditor of the accounts of Canada.

Direction of the
Governor in Council

(3) If, in the opinion of the Auditor General, a Crown corporation, in response to a request made under subsection (2), fails to provide any or sufficient information or explanations, he may so advise the Governor in Council, who may thereupon direct the officers of the corporation to furnish the Auditor General with such information and explanations and to give him access to those records, documents, books, accounts and vouchers of the corporation or any of its subsidiaries access to which is, in the opinion of the Auditor General, necessary for him to fulfil his responsibilities as the auditor of the accounts of Canada. 1976-77, c. 34, s. 14.

STAFF OF THE AUDITOR GENERAL

Officers, etc.	15. (1) Such officers and employees as are necessary to enable the Auditor General to perform his duties shall be appointed in accordance with the <i>Public Service Employment Act</i> .
Contract for professional services	(2) Subject to any other Act of Parliament or regulations made thereunder, but without the approval of the Treasury Board, the Auditor General may, within the total dollar limitations established for his office in appropriation Acts, contract for professional services.
Delegation to Auditor General	(3) The Auditor General may exercise and perform, in such manner and subject to such terms and conditions as the Public Service Commission directs, the powers, duties and functions of the Public Service Commission under the <i>Public Service Employment Act</i> , other than the powers, duties and functions of the Commission in relation to appeals under section 21 of that Act and inquiries under section 34 of that Act.
Suspension	(4) The Auditor General may suspend from the performance of his duty any person employed in his office. 1976-77, c. 34, s. 15; 1992, c. 54, s. 79.
Appointment of Commissioner	15.1 (1) The Auditor General shall, in accordance with the <i>Public Service Employment Act</i> , appoint a senior officer to be called the Commissioner of the Environment and Sustainable Development who shall report directly to the Auditor General.
Commissioner's duties	(2) The Commissioner shall assist the Auditor General in performing the duties of the Auditor General set out in this Act that relate to the environment and sustainable development. 1995, c. 43, s. 4.
Responsibility for personnel management	16. In respect of persons employed in his office, the Auditor General is authorized to exercise the powers and perform the duties and functions of the Treasury Board under the <i>Financial Administration Act</i> that relate to personnel management including the determination of terms and conditions of employment and the responsibility for employer and employee relations, within the meaning of paragraph 7(1)(e) and sections 11 to 13 of that Act. 1976-77, c. 34, s.16.
Classification standards	17. Classification standards may be prepared for persons employed in the office of the Auditor General to conform with the classifications that the Auditor General recognizes for the purposes of that office. 1976-77, c. 34, s. 18.
Delegation	18. The Auditor General may designate a senior member of his staff to sign on his behalf any opinion that he is required to give and any report, other than his annual report on the financial statements of Canada made pursuant to section 64 of the <i>Financial Administration Act</i> and his reports to the House of Commons under this Act, and any member so signing an opinion or report shall indicate beneath his signature his position in the office of the Auditor General and the fact that he is signing on behalf of the Auditor General. 1976-77, c. 34, s. 19.

ESTIMATES

Estimates	19. (1) The Auditor General shall annually prepare an estimate of the sums that will be required to be provided by Parliament for the payment of the salaries, allowances and expenses of his office during the next ensuing fiscal year.
Special report	(2) The Auditor General may make a special report to the House of Commons in the event that amounts provided for his office in the estimates submitted to Parliament are, in his opinion, inadequate to enable him to fulfil the responsibilities of his office. 1976-77, c. 34, s. 20.

Appropriation
allotments

20. The provisions of the *Financial Administration Act* with respect to the division of appropriations into allotments do not apply in respect of appropriations for the office of the Auditor General. 1976-77, c. 34, s. 21.

AUDIT OF THE OFFICE OF THE AUDITOR GENERAL

Audit of the office of
the Auditor General

21. (1) A qualified auditor nominated by the Treasury Board shall examine the receipts and disbursements of the office of the Auditor General and shall report annually the outcome of his examinations to the House of Commons.

Submission of
reports and tabling

(2) Each report referred to in subsection (1) shall be submitted to the President of the Treasury Board on or before the 31st day of December in the year to which the report relates and the President of the Treasury Board shall lay each such report before the House of Commons within fifteen days after receipt thereof by him or, if that House is not then sitting, on any of the first fifteen days next thereafter that the House of Commons is sitting. 1976-77, c. 34, s. 22.

SUSTAINABLE DEVELOPMENT

Purpose

21.1 The purpose of the Commissioner is to provide sustainable development monitoring and reporting on the progress of category I departments towards sustainable development, which is a continually evolving concept based on the integration of social, economic and environmental concerns, and which may be achieved by, among other things,

- (a) the integration of the environment and the economy;
- (b) protecting the health of Canadians;
- (c) protecting ecosystems;
- (d) meeting international obligations;
- (e) promoting equity;
- (f) an integrated approach to planning and making decisions that takes into account the environmental and natural resource costs of different economic options and the economic costs of different environmental and natural resource options;
- (g) preventing pollution; and
- (h) respect for nature and the needs of future generations. 1995, c. 43, s. 5.

Petitions received

22. (1) Where the Auditor General receives a petition in writing from a resident of Canada about an environmental matter in the context of sustainable development that is the responsibility of a category I department, the Auditor General shall make a record of the petition and forward the petition within fifteen days after the day on which it is received to the appropriate Minister for the department.

Acknowledgement
to be sent

(2) Within fifteen days after the day on which the Minister receives the petition from the Auditor General, the Minister shall send to the person who made the petition an acknowledgement of receipt of the petition and shall send a copy of the acknowledgement to the Auditor General.

Minister to respond	<p>(3) The Minister shall consider the petition and send to the person who made it a reply that responds to it, and shall send a copy of the reply to the Auditor General, within</p> <p>(a) one hundred and twenty days after the day on which the Minister receives the petition from the Auditor General; or</p> <p>(b) any longer time, where the Minister personally, within those one hundred and twenty days, notifies the person who made the petition that it is not possible to reply within those one hundred and twenty days and sends a copy of that notification to the Auditor General.</p>
Multiple petitioners	<p>(4) Where the petition is from more than one person, it is sufficient for the Minister to send the acknowledgement and reply, and the notification, if any, to one or more of the petitioners rather than to all of them. 1995, c. 43, s. 5.</p>
Duty to monitor	<p>23. (1) The Commissioner shall make any examinations and inquiries that the Commissioner considers necessary in order to monitor</p> <p>(a) the extent to which category I departments have met the objectives, and implemented the plans, set out in their sustainable development strategies laid before the House of Commons under section 24; and</p> <p>(b) the replies by Ministers required by subsection 22(3).</p>
Commissioner's report	<p>(2) The Commissioner shall, on behalf of the Auditor General, report annually to the House of Commons concerning anything that the Commissioner considers should be brought to the attention of that House in relation to environmental and other aspects of sustainable development, including</p> <p>(a) the extent to which category I departments have met the objectives, and implemented the plans, set out in their sustainable development strategies laid before that House under section 24;</p> <p>(b) the number of petitions recorded as required by subsection 22(1), the subject-matter of the petitions and their status; and</p> <p>(c) the exercising of the authority of the Governor in Council under any of subsections 24(3) to (5).</p>
Submission and tabling of report	<p>(3) The report required by subsection (2) shall be submitted to the Speaker of the House of Commons and shall be laid before that House by the Speaker on any of the next fifteen days on which that House is sitting after the Speaker receives it. 1995, c. 43, s. 5.</p>
Strategies to be tabled	<p>24. (1) The appropriate Minister for each category I department shall cause the department to prepare a sustainable development strategy for the department and shall cause the strategy to be laid before the House of Commons</p> <p>(a) within two years after this subsection comes into force; or</p> <p>(b) in the case of a department that becomes a category I department on a day after this subsection comes into force, before the earlier of the second anniversary of that day and a day fixed by the Governor in Council pursuant to subsection (4).</p>
Updated strategies to be tabled	<p>(2) The appropriate Minister for the category I department shall cause the department's sustainable development strategy to be updated at least every three years and shall cause each updated strategy to be laid before the House of Commons on any of the next fifteen days on which that House is sitting after the strategy is updated.</p>

- Governor in Council direction** (3) The Governor in Council may, on that recommendation of the appropriate Minister for a department not named in Schedule I to the *Financial Administration Act*, direct that the requirements of subsections (1) and (2) apply in respect of the department.
- Date fixed by Governor in Council** (4) On the recommendation of the appropriate Minister for a department that becomes a category I department after this subsection comes into force, the Governor in Council may, for the purpose of subsection (1), fix the day before which the sustainable development strategy of the department shall be laid before the House of Commons.
- Regulations** (5) The Governor in Council may, on the recommendation of the Minister of the Environment, make regulations prescribing the form in which sustainable development strategies are to be prepared and the information required to be contained in them. 1995, c. 43, s. 5.

APPENDIX B

FINANCIAL ADMINISTRATION ACT

R.S., c. F-11

Extracts from Part X

CROWN CORPORATIONS

Financial Management

Books and systems	<p>131. (1) Each parent Crown corporation shall cause</p> <p>(a) books of account and records in relation thereto to be kept, and</p> <p>(b) financial and management control and information systems and management practices to be maintained,</p> <p>in respect of itself and each of its wholly-owned subsidiaries, if any.</p>
Idem	<p>(2) The books, records, systems and practices referred to in subsection (1) shall be kept and maintained in such manner as will provide reasonable assurance that</p> <p>(a) the assets of the corporation and each subsidiary are safeguarded and controlled;</p> <p>(b) the transactions of the corporation and each subsidiary are in accordance with this Part, the regulations, the charter and by-laws of the corporation or subsidiary and any directive given to the corporation; and</p> <p>(c) the financial, human and physical resources of the corporation and each subsidiary are managed economically and efficiently and the operations of the corporation and each subsidiary are carried out effectively.</p>
Internal audit	<p>(3) Each parent Crown corporation shall cause internal audits to be conducted, in respect of itself and each of its wholly-owned subsidiaries, if any, to assess compliance with subsections (1) and (2), unless the Governor in Council is of the opinion that the benefits to be derived from those audits do not justify their cost.</p>
Financial statements	<p>(4) Each parent Crown corporation shall cause financial statements to be prepared annually, in respect of itself and its wholly-owned subsidiaries, if any, in accordance with generally accepted accounting principles as supplemented or augmented by regulations made pursuant to subsection (6) if any.</p>
Form of financial statements	<p>(5) The financial statements of a parent Crown corporation and of a wholly-owned subsidiary shall be prepared in a form that clearly sets out information according to the major businesses or activities of the corporation or subsidiary.</p>
Regulations	<p>(6) The Treasury Board may, for the purposes of subsection (4), make regulations respecting financial statements either generally or in respect of any specified parent Crown corporation or any parent Crown corporation of a specified class, but such regulations shall, in</p>

respect of the preparation of financial statements, only supplement or augment generally accepted accounting principles. 1991, c. 24, s. 41.

Auditor's Reports

Annual auditor's report	<p>132. (1) Each parent Crown corporation shall cause an annual auditor's report to be prepared, in respect of itself and its wholly-owned subsidiaries, if any, in accordance with the regulations, on</p>
	<p>(a) the financial statements referred to in section 131 and any revised financial statement referred to in subsection 133(3); and</p>
	<p>(b) any quantitative information required to be audited pursuant to subsection (5).</p>
Contents	<p>(2) A report under subsection (1) shall be addressed to the appropriate Minister and shall</p>
	<p>(a) include separate statements, whether in the auditor's opinion,</p> <p>(i) the financial statements are presented fairly in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year,</p> <p>(ii) the quantitative information is accurate in all material respects and, if applicable, was prepared on a basis consistent with that of the preceding year, and</p> <p>(iii) the transactions of the corporation and of each subsidiary that have come to his notice in the course of the auditor's examination for the report were in accordance with this Part, the regulations, the charter and by-laws of the corporation or subsidiary and any directive given to the corporation; and</p> <p>(b) call attention to any other matter falling within the scope of the auditor's examination for the report that, in his opinion, should be brought to the attention of Parliament.</p>
Regulations	<p>(3) The Treasury Board may make regulations prescribing the form and manner in which the report referred to in subsection (1) is to be prepared.</p>
Separate reports	<p>(4) Notwithstanding any other provision of this Part, the auditor of a parent Crown corporation may prepare separate annual auditor's reports on the statements referred to in paragraph (1)(a) and on the information referred to in paragraph (1)(b) if, in the auditor's opinion, separate reports would be more appropriate.</p>
Audit of quantitative information	<p>(5) The Treasury Board may require that any quantitative information required to be included in a parent Crown corporation's annual report pursuant to subsection 150(3) be audited.</p>
Other reports	<p>(6) The auditor of a parent Crown corporation shall prepare such other reports respecting the corporation or any wholly-owned subsidiary of the corporation as the Governor in Council may require.</p>
Examination	<p>(7) An auditor shall make such examination as he considers necessary to enable him to prepare a report under subsection (1) or (6).</p>

Reliance on internal audit	(8) An auditor shall, to the extent he considers practicable, rely on any internal audit of the corporation being audited that is conducted pursuant to subsection 131(3). 1991, c. 24, s. 42.
Errors and omissions	133. (1) A director or officer of a Crown corporation shall forthwith notify the auditor and the audit committee of the corporation, if any, of any error or omission of which the director or officer becomes aware in a financial statement that the auditor or a former auditor has reported on or in a report prepared by the auditor or a former auditor pursuant to section 132.
Idem	(2) Where an auditor or former auditor of a Crown corporation is notified or becomes aware of any error or omission in a financial statement that the auditor or former auditor has reported on or in a report prepared by the auditor or former auditor pursuant to section 132, he shall forthwith notify each director of the corporation of the error or omission if he is of the opinion that the error or omission is material.
Correction	(3) Where an auditor or former auditor of a Crown corporation notifies the directors of an error or omission in a financial statement or report pursuant to subsection (2), the corporation shall prepare a revised financial statement or the auditor or former auditor shall issue a correction to the report, as the case may be, and a copy thereof shall be given to the appropriate Minister. 1984, c. 31, s. 11.

Auditors

Appointment of auditor	134. (1) The auditor of a parent Crown corporation shall be appointed annually by the Governor in Council, after the appropriate Minister has consulted the board of directors of the corporation, and may be removed at any time by the Governor in Council, after the appropriate Minister has consulted the board.
Auditor General	(2) On and after January 1, 1989, the Auditor General of Canada shall be appointed by the Governor in Council as the auditor, or a joint auditor, of each parent Crown corporation named in Part I of Schedule III, unless the Auditor General waives the requirement that he be so appointed.
Idem	(3) Subsections (1) and (2) do not apply in respect of any parent Crown corporation the auditor of which is specified by any other Act of Parliament to be the Auditor General of Canada, but the Auditor General is eligible to be appointed the auditor, or a joint auditor, of a parent Crown corporation pursuant to subsection (1) and section 135 does not apply to him.
Exception	(4) Notwithstanding subsection (1), where the report referred to in subsection 132(1) is to be prepared in respect of a wholly-owned subsidiary separately, the board of directors of the parent Crown corporation that wholly owns the subsidiary shall, after consultation with the board of directors of the subsidiary, appoint the auditor of the subsidiary, and subsections (6) and sections 135 to 137 apply in respect of that auditor as though the references therein to a parent Crown corporation were references to the subsidiary.
Criteria for appointment	(5) The Governor in Council may make regulations prescribing the criteria to be applied in selecting an auditor for appointment pursuant to subsection (1) or (4).
Re-appointment	(6) An auditor of a parent Crown corporation is eligible for re-appointment on the expiration of his appointment.

Continuation in office	(7) Notwithstanding subsection (1), if an auditor of a parent Crown corporation is not appointed to take office on the expiration of the appointment of an incumbent auditor, the incumbent auditor continues in office until his successor is appointed. 1984, c.31, s.11.
Persons not eligible	135. (1) A person is disqualified from being appointed or re-appointed or continuing as an auditor of a parent Crown corporation pursuant to section 134 if that person is not independent of the corporation, any of its affiliates, or the directors or officers of the corporation or any of its affiliates.
Independence	(2) For the purpose of this section, <ul style="list-style-type: none"> (a) independence is a question of fact; and (b) a person is deemed not to be independent if that person or any of his business partners <ul style="list-style-type: none"> (i) is a business partner, director, officer or employee of the parent Crown corporation or any of its affiliates, or a business partner of any director, officer or employee of the corporation or any of its affiliates, (ii) beneficially owns or controls, directly or indirectly through a trustee, legal representative, agent or other intermediary, a material interest in the shares or debt of the parent Crown corporation or any of its affiliates, or (iii) has been a receiver, receiver-manager, liquidator or trustee in bankruptcy of the parent Crown corporation or any of its affiliates within two years of his proposed appointment as auditor of the corporation.
Resignation	(3) An auditor of a parent Crown corporation who becomes disqualified under this section shall resign forthwith after becoming aware of his disqualification. 1984, c.31, s.11.
Qualifications preserved	136. Nothing in sections 134 and 135 shall be construed as empowering the appointment, re-appointment or continuation in office as an auditor of a parent Crown corporation of any person who does not meet any qualifications for such appointment, re-appointment or continuation established by any other Act of Parliament. 1984, c. 31, s. 11.
Resignation	137. A resignation of an auditor of a parent Crown corporation becomes effective at the time the corporation receives a written resignation from the auditor or at the time specified in the resignation, whichever is later. 1984, c. 31, s. 11.

Special Examination

Special examination	138. (1) Each parent Crown corporation shall cause a special examination to be carried out in respect of itself and its wholly-owned subsidiaries, if any, to determine if the systems and practices referred to in paragraph 131(1)(b) were, in the period under examination, maintained in a manner that provided reasonable assurance that they met the requirements of paragraphs 131(2)(a) and (c).
Time for examination	(2) A special examination shall be carried out at least once every five years and at such additional times as the Governor in Council, the appropriate Minister or the board of directors of the corporation to be examined may require.

Plan	(3) Before an examiner commences a special examination, he shall survey the systems and practices of the corporation to be examined and submit a plan for the examination, including a statement of the criteria to be applied in the examination, to the audit committee of the corporation, or if there is no audit committee, to the board of directors of the corporation.
Resolution of disagreements	(4) Any disagreement between the examiner and the audit committee or board of directors of a corporation with respect to a plan referred to in subsection (3) may be resolved <ul style="list-style-type: none"> (a) in the case of a parent Crown corporation, by the appropriate Minister; and (b) in the case of a wholly-owned subsidiary, by the parent Crown corporation that wholly owns the subsidiary.
Reliance on internal audit	(5) An examiner shall, to the extent he considers practicable, rely on any internal audit of the corporation being examined conducted pursuant to subsection 131(3). 1984, c.31, s.11.
Report	139. (1) An examiner shall, on completion of the special examination, submit a report on his findings to the board of directors of the corporation examined.
Contents	(2) The report of an examiner under subsection (1) shall include <ul style="list-style-type: none"> (a) a statement, whether in the examiner's opinion, with respect to the criteria established pursuant to subsection 138(3), there is reasonable assurance that there are no significant deficiencies in the systems and practices examined; and (b) a statement of the extent to which the examiner relied on internal audits. 1984, c.31, s.11.
Special report of appropriate Minister	140. Where the examiner of a parent Crown corporation, or a wholly owned subsidiary of a parent Crown corporation, named in Part I of Schedule III is of the opinion that his report under subsection 139(1) contains information that should be brought to the attention of the appropriate Minister, he shall, after consultation with the board of directors of the corporation, or with the board of the subsidiary and corporation, as the case may be, report that information to the Minister and furnish the board or boards with a copy of the report. 1984, c.31, s.11.
Special report to Parliament	141. Where the examiner of a parent Crown corporation, or a wholly-owned subsidiary of a parent Crown corporation, named in Part I of Schedule III of the opinion that his report under subsection 139(1) contains information that should be brought to the attention of Parliament, he shall, after consultation with the appropriate Minister and the board of directors of the corporation, or with the boards of the subsidiary and corporation, as the case may be, prepare a report thereon for inclusion in the next annual report of the corporation and furnish the board or boards, the appropriate Minister and the Auditor General of Canada with copies of the report. 1984, c.31, s.11.
Examiner	142. (1) Subject to subsections (2) and (3), a special examination referred to in section 138 shall be carried out by the auditor of a parent Crown corporation.
Idem	(2) Where, in the opinion of the Governor in Council, a person other than the auditor of a parent Crown corporation should carry out a special examination, the Governor in Council may, after the appropriate Minister has consulted the board of directors of the corporation, appoint an auditor who is qualified for the purpose to carry out the examination in lieu of the

auditor of the corporation and may, after the appropriate Minister has consulted the board, remove that qualified auditor at any time.

Exception

(3) Where a special examination is to be carried out in respect of a wholly-owned subsidiary separately, the board of directors of the parent Crown corporation that wholly owns the subsidiary shall, after consultation with the board of directors of the subsidiary, appoint the qualified auditor who is to carry out the special examination.

Applicable provisions

(4) Subject to subsection (5), sections 135 and 137 apply in respect of an examiner as though the references therein to an auditor were references to an examiner.

Auditor General eligible

(5) The Auditor General of Canada is eligible to be appointed an examiner and section 135 does not apply to the Auditor General of Canada in respect of such an appointment. 1984, c. 31, s. 11.

Consultation with Auditor General

Consultation with Auditor General

143. The auditor or examiner of a Crown corporation may at any time consult the Auditor General of Canada on any matter relating to his audit or special examination and shall consult the Auditor General with respect to any matter that, in the opinion of the auditor or examiner, should be brought to the attention of Parliament pursuant to paragraph 132(2)(b) or section 141. 1984, c. 31, s. 11.

Right to Information

Right to Information

144. (1) On the demand of the auditor or examiner of a Crown corporation, the present or former directors, officers, employees or agents of the corporation shall furnish such

(a) information and explanations, and

(b) access to records, documents, books, accounts and vouchers of the corporation or any of its subsidiaries

as the auditor or examiner considers necessary to enable him to prepare any report as required by this Division and that the directors, officers, employees or agents are reasonably able to furnish.

Idem

(2) On the demand of the auditor or examiner of a Crown corporation, the directors of the corporation shall

(a) obtain from the present or former directors, officers, employees or agents of any subsidiary of the corporation such information and explanations as the auditor or examiner considers necessary to enable him to prepare any report as required by this Division and that the present or former directors, officers, employees or agents are reasonably able to furnish; and

(b) furnish the auditor or examiner with the information and explanations so obtained.

Reliance on reports

(3) An auditor or examiner of a Crown corporation may reasonably rely on any report of any other auditor or examiner. 1984, c. 31, s. 11.

Policy

Restriction

145. Nothing in this Part or the regulations shall be construed as authorizing the auditor or examiner of a Crown corporation to express any opinion on the merits of matters of policy, including the merits of

- (a) the objects or purposes for which the corporation is incorporated, or the restrictions on the businesses or activities that it may carry on, as set out in its charter;
- (b) the objectives of the corporation; and
- (c) any business or policy decision of the corporation or of the Government of Canada. 1984, c. 31, s. 11.

Qualified Privilege

Qualified privilege

146. Any oral or written statement or report made under this Part or the regulations by the auditor or a former auditor, or the examiner or a former examiner, of a parent Crown corporation or a wholly-owned subsidiary has qualified privilege. 1991, c. 24, s. 43.

Costs

Cost of audit and examination

147. (1) The amounts paid to an auditor or examiner of a Crown corporation for preparing any report under section 132, 139, 140 or 141 shall be reported to the President of the Treasury Board.

Idem

(2) Where the Auditor General of Canada is the auditor or examiner of a Crown corporation, the costs incurred by him in preparing any report under section 132, 139, 140 or 141 shall be disclosed in the next annual report of the Auditor General and be paid out of the moneys appropriated for his office. 1984, c. 31, s. 11.

Audit Committee

Audit committee

148. (1) Each parent Crown corporation that has four or more directors shall establish an audit committee composed of not less than three directors of the corporation, the majority of whom are not officers or employees of the corporation or any of its affiliates.

Idem

(2) In the case of a parent Crown corporation that has less than four directors, the board of directors of the corporation constitutes the audit committee of the corporation and shall perform the duties and functions assigned to an audit committee by any provision of this Part and the provision shall be construed accordingly.

Duties

- (3) The audit committee of a parent Crown corporation shall
 - (a) review, and advise the board of directors with respect to, the financial statements that are to be included in the annual report of the corporation;
 - (b) oversee any internal audit of the corporation that is conducted pursuant to subsection 131(3);

(c) review, and advise the board of directors with respect to, the annual auditor's report of the corporation referred to in subsection 132(1);

(d) in the case of a corporation undergoing a special examination, review, and advise the board of directors with respect to, the plan and reports referred to in sections 138 to 141; and

(e) perform such other functions as are assigned to it by the board of directors or the charter or by-laws of the corporation.

Auditor's or
examiner's
attendance

(4) The auditor and any examiner of a parent Crown corporation are entitled to receive notice of every meeting of the audit committee and, at the expense of the corporation, to attend and be heard at each meeting; and, if so requested by a member of the audit committee, the auditor or examiner shall attend any or every meeting of the committee held during his term of office.

Calling meeting

(5) The auditor or examiner of a parent Crown corporation or a member of the audit committee may call a meeting of the committee.

Wholly-owned
subsidiary

(6) Where the report referred to in subsection 132(1) is to be prepared in respect of a wholly-owned subsidiary separately, subsections (1) to (5) apply, with such modifications as the circumstances require, in respect of the subsidiary as though

(a) the references in subsections (1) to (5) to a parent Crown corporation were references to the subsidiary; and

(b) the reference in paragraph (3)(a) to the annual report of the corporation were a reference to the annual report of the parent Crown corporation that wholly owns the subsidiary. 1984, c. 31, s. 11.

Reports

Accounts, etc. to
Treasury Board or
appropriate
Minister

149. (1) A parent Crown corporation shall provide the Treasury Board or the appropriate Minister with such accounts, budgets, returns, statements, documents, records, books, reports or other information as the Board or appropriate Minister may require.

Reports on
material
developments

(2) The chief executive officer of a parent Crown corporation shall, as soon as reasonably practicable, notify the appropriate Minister, the President of the Treasury Board and any director of the corporation not already aware thereof of any financial or other developments that, in the chief executive officer's opinion, are likely to have a material effect on the performance of the corporation, including its wholly-owned subsidiaries, if any, relative to the corporation's objectives or on the corporation's requirements for funding.

Reports on
wholly-owned
subsidiaries

(3) Each parent Crown corporation shall forthwith notify the appropriate Minister and the President of the Treasury Board of the name of any corporation that becomes or ceases to be a wholly-owned subsidiary of the corporation. 1984, c. 31, s. 11.

Annual report

150. (1) Each parent Crown corporation shall, as soon as possible, but in any case within three months, after the termination of each financial year submit an annual report on the operations of the corporation in that year concurrently to the appropriate Minister and the President of the Treasury Board, and the appropriate Minister shall cause a copy of the report to be laid before each House of Parliament on any of the first fifteen days on which that House is sitting after he receives it.

Reference to committee	(2) An annual report laid before Parliament pursuant to subsection (1) stands permanently referred to such committee of Parliament as may be designated or established to review matters relating to the businesses and activities of the corporation submitting the report.
Form and contents	<p>(3) The annual report of a parent Crown corporation shall include</p> <p>(a) the financial statements of the corporation referred to in section 131,</p> <p>(b) the annual auditor's report referred to in subsection 132(1),</p> <p>(c) a statement on the extent to which the corporation has met its objectives for the financial year,</p> <p>(d) such quantitative information respecting the performance of the corporation, including its wholly-owned subsidiaries, if any, relative to the corporation's objectives as the Treasury Board may require to be included in the annual report, and</p> <p>(e) such other information as is required by this or any other Act of Parliament, or by the appropriate Minister, the President of the Treasury Board or the Minister of Finance, to be included in the annual report,</p> <p>and shall be prepared in a form that clearly sets out information according to the major businesses or activities of the corporation and its wholly-owned subsidiaries, if any.</p>
Idem	(4) In addition to any other requirements under this Act or any other Act of Parliament, the Treasury Board may, by regulation, prescribe the information to be included in annual reports and the form in which such information is to be prepared. 1991, c. 24, s. 49.
Annual consolidated report	151. (1) The President of the Treasury Board shall, not later than December 31 of each year, cause a copy of an annual consolidated report on the businesses and activities of all parent Crown corporations for their financial years ending on or before the previous July 31 to be laid before each House of Parliament.
Reference to committee	(2) An annual consolidated report laid before Parliament pursuant to subsection (1) stands permanently referred to such committee of Parliament as may be designated or established to review matters relating to Crown corporations.
Contents	<p>(3) The annual consolidated report referred to in subsection (1) shall include</p> <p>(a) a list naming, as of a specified date, all Crown corporations and all corporations of which any shares are held by, on behalf of or in trust for the Crown or any Crown corporation;</p> <p>(b) employment and financial data, including aggregate borrowings of parent Crown corporations; and</p> <p>(c) such other information as the President of the Treasury Board may determine. 1984, c. 31, s. 11.</p>
Annual report	152. (1) The President of the Treasury Board shall, not later than December 31 of each year, cause to be laid before each House of Parliament a copy of a report indicating the

summaries and annual reports that under this Part were to be laid before that House by July 31 in that year, the time at, before or within which they were to be laid and the time they were laid before that House.

Attest

(2) The accuracy of the information contained in the report referred to in subsection (1) shall be attested by the Auditor General of Canada in the Auditor General's report to the House of Commons. 1991, c. 24, s. 44.

APPENDIX C

REPORTS TO THE HOUSE

Thursday, November 9, 1995

The Standing Committee on Public Accounts has the honour to present its

SIXTEENTH REPORT

Pursuant to Standing Order 108(3)(d), the Committee has studied Chapters 9 (*Overall Management of Federal Science and Technology Activities*), 10 (*Management of Departmental Science and Technology Activities*) and 11 (*Management of Scientific Personnel in Federal Research Establishments*) of the 1994 Report of the Auditor General.

Introduction and Context

The Report of the Auditor General for 1994 contained four chapters relating to science and technology. The Committee has already reviewed one of those chapters on March 14, 1995 — Income Tax Incentives for Research and Development — and has reported to the House thereon. The Committee held two meetings on the subject, on March 28 and May 9, 1995, with senior officials of Industry Canada (and the Communications Research Centre), the Treasury Board Secretariat and the Office of the Auditor General.

There is general agreement that science and technology make a significant contribution to economic growth and to Canadians' quality of life. The federal government allocates large sums of money to science and technology activities. In 1993–1994, it spent about \$6 billion on these types of activities, excluding the \$1 billion in tax credits.

Federal science and technology funds are mainly allocated (\$3.5 billion) to various federal organizations (intramural activities). The activities are managed and conducted by some 35,000 federal public servants, including 19,000 scientists. Seventeen organizations share more than 90% of the resources. Other federal funds are allocated to industry, universities, foreign interests and other.

Chapters 9 and 10

In its 1994 Budget, the government recognized the need to “put in place a true strategy for R & D, one with real priorities, real direction, and a real review of results”. After completing various stages in the federal review of science and technology, the government was to make its new strategy known shortly. The Deputy Minister of Science and Technology, Harry Swain, indicated at the meeting on May 9 of this year that the date when the new strategy would be tabled was a decision for the government to make, but that the Department would comply with the deadlines imposed. The end of June has been suggested as the anticipated timeframe. However, nothing has yet been tabled by the government, and time is growing short.

The Committee does not question this approach, which should assist the government in managing its science and technology portfolio more effectively. However, it is puzzled about the Auditor General's comments that while they have been the subjects of discussion and controversy for more than three decades, the issues of strategy, priority and results have never been resolved. The same comments apply to the issue of the management of scientific personnel.

The Committee wishes to ensure that all the elements that are necessary for the strategy to be implemented and succeed are in place. In Chapter 9 of his Report, the Auditor General refers to four elements that the government should include in its strategy:

(1) Establishment of strategies and priorities; (2) Framework for coordinating activities of departments and agencies; (3) Framework for evaluating results; (4) Information for Parliament and the general public for purposes of accountability.

At its meeting, the Committee sought to know what the government intended to do to incorporate these elements in its strategy. With respect to establishing priorities, discussions have been held on the cuts made in the budgets of the granting councils. The Committee wondered whether this choice had been made from a strategic perspective. The Deputy Minister assured that Committee that this was the case. In his opening statement, Mr. Swain mentioned that the federal science and technology review played a significant role in establishing priorities for the 1995 Budget and the Program Review. For example, priority was given by the government to activities which encourage innovation and rapid commercialization of new ideas.

In addition to establishing priorities, the Committee is of the opinion that the government must set a direction on what must be done. A link must be made between activities that should be undertaken and the resources needed to do so. This presupposes changes in the current structure of the departments and agencies, and in the management of their activities. If other entities such as the university sector were able to serve government objectives better, appropriate choices would have to be made. The Committee believes that it is important that everyone know what is expected of him or her, so that everyone can make the maximum contribution to achieving priorities. For example, the Committee believes that more attention needs to be placed on business development activities. Research establishments should develop internal capacities to identify potential clients and partners and to promote their services. Some organizations have already put in place some business development and marketing activities. However, more effort should be made to promote the commercialization of technologies and products. The government will have to clearly communicate to the departments what direction is to be taken, from the outset.

Since there are a number of departments and agencies working in the field of science and technology, mechanisms must be put in place to encourage congruence of policies and objectives. Even if all departments can redefine themselves in terms of the new strategy, they must be positioned on the basis of their interactions. The second element to be included in the government's strategy is a framework for coordinating the activities of departments and agencies. At the meeting, Mr. Swain stated that he agreed with this. He added that the process leading up to the 1995 Budget has resulted in departments working together much more closely than in the past. However, the Committee believes that more than this is needed. It acknowledges that it is not easy to determine the best model for managing science and technology activities. At the meeting, it tried to learn more about the government's intentions, but the decision as to what model would be adopted did not seem to have been made. For example, there are some who advocate grouping scientific activities under a single department. Whatever structure is chosen, the Committee believes that the entity that will coordinate science and technology policy will have to have the necessary authority and the credibility required to play this role with respect to the other departments. The government will also have to provide clear and consistent leadership if it wants to achieve its goals.

The third element to be incorporated into the government's new strategy is a framework for evaluating results. In the Committee's view, the government must know what kind of achievements are being made, and in order to do this it must have information on planned and actual results. This presupposes the establishment of measurable objectives and performance indicators. Once again, Mr. Swain stated that he is in favour of this approach. In an internal report on federal science and technology activities, the authors recommended that Statistics Canada establish an on-going development project to design, plan and implement an extended program of output-oriented statistics and indicators. The Committee believes that this would be a step in the right direction. The government will have to ensure that Statistics Canada has the resources needed for carrying out this project.

The fourth essential element in the government's strategy is information for Parliament and the general public. The public is entitled to know whether the government has met its objectives, and what it cost. Instead, what is currently available is information on program input such as expenditures and human resources assigned to the various activities. At the meeting, Mr. Swain contended that a problem arises because of the differences between the vertical responsibilities of departments and the horizontal approach to science and technology activities. The

Committee still believes that the necessary steps must be taken to coordinate information on overall administration. The agency that is in charge of coordinating science and technology activities will have to perform this task.

The Committee believes that the weaknesses observed by the Auditor General in Chapter 10 on the Management of Departmental Science and Technology Activities are largely the result of the absence of any true comprehensive strategy. In recent years, departments and agencies have received no clear signals as to the direction they should give to their activities. To assist the government in implementing its strategy, departments and agencies will have to adopt precise goals and concentrate on achieving results. All stages of project management (project selection, anticipated results, information on costs, evaluation, etc.) will have to be reviewed so that departments and agencies are in a position to assess the effectiveness of their science activities.

The Committee is impatiently awaiting the tabling of the new strategy. The 1995 Budget has already made known the government's intentions in terms of orientating its science and technology activities toward activities that encourage innovation, rapid commercialization and value-added production. The challenge will be to translate these intentions into concrete actions.

The Committee intends to monitor the government's progress in implementing its strategy closely. It wishes to ensure that elements are in place so that the measures taken by the government are able to produce real change. However, the Committee believes that the Office of the Auditor General can perform this task more effectively. Accordingly, the Committee recommends:

That the Auditor General, on behalf of the Committee, review the federal government's science and technology strategy once it is tabled. The Auditor General shall, within 60 days, inform the Committee whether the following elements are present and/or planned: (1) Clearly established priorities and coherent direction; (2) Framework for coordinating the activities of departments and agencies; (3) Framework for evaluating results; (4) Information for Parliament and the general public for purposes of accountability; and (5) A plan (at the central and/or departmental level) for developing ways and means to ensure research gets into the market place. The Auditor General shall state his opinion as to whether the strategy satisfies the concerns he raised in Chapters 9 and 10 of his 1994 Annual Report.

Chapter 11

The nature of scientists' work is such that they may be viewed very differently from other occupational groups. For one thing, they are required to have very specific knowledge about certain fields. Often, they must hold advanced academic degrees. Because of this they undoubtedly begin their careers later than other occupational groups. For another, the fact that scientists specialize in extremely specific fields makes them less mobile. It is sometimes difficult to find another position for an employee whose project has been completed.

There is no doubt that the contribution made by scientific personnel in departments and agencies is essential if the government's science and technology objectives are to be achieved. On the other hand, we can say that any change in government plans in this area will have an impact on human resources. In fact, not only will scientific personnel be affected by the budget cuts announced in the 1995 Budget, but they will also have to adapt to the new role that the government intends to play in science and technology. In order to ensure that these radical changes will be implemented and that scientific personnel make a positive contribution to them, the performance of such personnel must be maximized through appropriate management practices. In concrete terms, this means that managers must be given the tools they need to do this.

The Committee was therefore not very reassured to learn that many of the problems relating to the management of scientific personnel that have been identified in studies done over the past 30 years have still not been resolved.

As the employer of the Public Service, Treasury Board has an important role to play in managing human resources. Among other things, it determines policies on human resources needs, remuneration and training. Treasury Board's somewhat standardized human resources guidelines may affect scientists more than other occupational groups. The question of fixed term contracts discussed at the meeting is a good example. Government policy makes a permanent job available to any employee hired on a temporary basis after five years, which often happens in scientific projects. Once a project concludes, the skills and qualifications of some of the scientists prove to be too narrow for them to be easily transferable to work on other projects. Managers therefore have to deal with less effective personnel for carrying out other projects.

The Committee wonders whether the approach taken to the management of scientific human resources in the Public Service should not be changed. At the meeting, the Committee noted that some departments have already indicated to Treasury Board that they wanted to have more flexibility in the rules. The Deputy Minister, Mr. Swain, said that departments may lay out their constraints and requests for exemptions in the business plans tabled with Treasury Board in the context of human resources management. On the other hand, these procedures take time. The Committee has learned that it took two and a half years for the Department of Defence and one and a half years for the Department of Agriculture to obtain certain exemptions to the five-year rule.

Other changes have been requested by the departments. In response to a request from the Committee, the Secretary of the Treasury Board forwarded a list of the flexibilities and changes requested by the departments for the management of their scientific personnel. Mr. Giroux also notes that "the Treasury Board Secretariat's intent is to work closely with departments to delegate authorities and to tailor policies to meet their unique business needs where they are consistent with cost-effective management".

Treasury Board seems to be open to increasing the latitude allowed to the departments. However, negotiations are at present conducted on a case-by-case basis. The Committee believes that this may not be the most efficient approach. The question of the five-year rule demonstrates that while some departments have obtained specific exemptions, the problem remains, because this is not available to all science agencies. Even an extremely dynamic establishment like the Communications Research Centre still faces numerous constraints in terms of human resources management. In some departments, scientific activities involve only a fraction of the department's activities, so that management problems affecting their scientists are not considered a priority.

In the Committee's view, Treasury Board could develop a better-adapted and more decentralized human resources management scheme which would still include suitable accountability mechanisms. Certain measures, such as retirement incentives, could apply to all departments, while others (special recruitment programs) would be applied to certain departments as required. At the meeting, Mr. Giroux mentioned that decentralization toward the departments to give them greater flexibility was the direction he wanted to take. The Committee acknowledges that Treasury Board has to deal with numerous constraints such as collective agreements. However, Treasury Board must solve the problems raised in the Auditor General's Report in a more definitive manner. Accordingly, the Committee recommends:

That Treasury Board determine what responsibilities and authorities it intends to transfer to the departments with the aim of making the framework for managing human resources more flexible and better adapted to their needs. For example, how Treasury Board can make exemptions from the policy on employees appointed for fixed terms exceeding five years available on a wider scale. Treasury Board will have to submit the timetable it adopts for this purpose to the Committee.

In the meantime, the Committee wants to know how negotiations on initiatives concerning the flexibilities and changes sought by the departments are progressing. The Committee received a status report in June 1995. It wishes to make this practice permanent. The Committee therefore recommends:

That in December 1995, and in June and December of each subsequent year, Treasury Board submit a report to the Committee on the status of current initiatives relating to the management of scientific personnel. The report shall detail the progress made in relation to the anticipated results.

At the meeting, it was suggested that a special forum devoted to issues involved in the management of scientific personnel should be created, as proposed by the Auditor General. According to Mr. Swain, in some sense the first meeting was held on May 8 of this year, when the heads of the various science agencies met to discuss these issues, among others. He thought that this approach could be expanded in the near future. The Committee wishes to ensure that this is done. Accordingly, it recommends:

That the Department of Industry inform the Committee of progress made in establishing a forum devoted to issues involved in the management of scientific personnel. The Department shall specify who participates in the forum, how often meetings are held, what its objectives are, and so on.

Finally, the Committee is concerned at the delay by the government in tabling of the new government science and technology strategy. It hopes that the strategy will contain elements that will address the question of the management of scientific personnel. In order to monitor this question closely, the Committee recommends:

That within 60 days after the government's science and technology strategy is tabled the Auditor General give his opinion as to whether the elements set out in that strategy satisfy the concerns he raised in Chapter 11 of his 1994 Report.

In accordance with Standing Order 109, the Committee requests that the government table a comprehensive response to this Report.

A copy of the relevant *Minutes of Proceedings (Issues nos. 32, 34 and 36 which includes this Report)* is tabled.

Respectfully submitted,

Richard Bélisle

Chair

REPORTS TO THE HOUSE

Monday, November 20, 1995

The Standing Committee on Public Accounts has the honour to present its

SEVENTEENTH REPORT

Pursuant to Standing Order 108(3)(d), the Committee considered Chapter 5 of the Report of the Auditor General, May 1995: *Office of the Superintendent of Financial Institutions — Deposit-Taking Institutions Sector*.

The importance of the financial services industry to Canada's economy and the concerns expressed by the Auditor General (AG) in this report led the Committee to consider the activities of the Office of the Superintendent of Financial Institutions (OSFI). The Committee therefore held a meeting on this subject on October 3, 1995 with representatives of OSFI and the Office of the Auditor General (OAG).

Introduction and Background

The purposes of the system of supervising and regulating federally-regulated financial institutions are to protect depositors from losses resulting from bankruptcies by these institutions, to maintain public confidence in them, and to encourage competition in the financial services industry. Nevertheless, no system, however sophisticated, can prevent all bankruptcies. The aim of the regulatory system is to assure Canadians that the financial services industry is sound and operates effectively.

OSFI is an important entity in the federal regulatory system. It is responsible for supervising and regulating banks and federally-regulated investment, trust and loan companies and co-operative credit societies in order to ensure that they are financially sound and comply with the legislation. In 1994, the consolidated assets of OSFI-supervised deposit-taking institutions and investment companies amounted to \$904 billion.

The federal regulatory system includes other entities in addition to OSFI. As well as providing deposit insurance, the Canada Deposit Insurance Corporation (CDIC) sets and promotes standards for sound commercial and financial practices. The Department of Finance develops policies and legislation concerning the financial services industry, and has overall responsibility for the workings of the system. The Bank of Canada acts as lender of last resort and has certain responsibilities concerning the operation of the payment system.

New legislation governing federally-regulated financial institutions came into effect in 1992. These legislative changes had four main objectives: (1) to benefit consumers by increasing competition and the variety of services offered by financial institutions; (2) to enhance protection for depositors and policyholders; (3) to strengthen the competitiveness of Canada's financial institutions; and (4) to lay the groundwork for discussions with the provinces on harmonization. Some of these objectives were already enshrined in the legislation or set out in public documents. The legislative framework has to be reviewed in 1997 since the statutes, which were proclaimed in 1992 and which govern the activities of the financial institutions, contained a five-year sunset clause.

The Committee believes that, in anticipation of the 1997 review of the regulatory system, it would be advisable for the government to seek to ascertain whether its objectives have been reached. The Committee considers that a program evaluation would identify which aspects of the regulatory system are producing the desired results and which must be changed. An evaluation would help determine whether the present regulatory system is the one most likely to achieve the objectives, or would suggest alternatives. It is of the utmost importance that the changes to be proposed in 1997 have a sound and logical basis. The Committee can only agree with one statement contained in the interim report on the 1992 legislation by the Standing Senate Committee on Banking, Trade and

Commerce: “High standards of proof are going to be required on [certain] questions (Is there adequate competition in the system?). Answers to these questions which consist essentially of assertions that are designed primarily to support an industry’s position with respect to its preferred shape for the financial services sector of the future will play no useful role in the forthcoming debate.” (page 14) The Committee is all the more convinced of the need for a program evaluation since the AG noted in his report that no comprehensive evaluation of the system has been carried out in order to ascertain whether the government is reaching its objectives for the financial services industry.

The Committee recognizes that such a task is not easy, particularly since action must be taken promptly if the results of the evaluation are to be available before the 1997 changes are proposed. However, the Committee believes that such an evaluation is not an impossible challenge. Since more than one entity is involved, each one will have to contribute if the evaluation is to be successful. OSFI Superintendent John Palmer seems to agree to participate in an evaluation. At the meeting, he stated: “This recommendation [by the AG for a comprehensive evaluation of the regulatory system] is understandable and touches on evaluating broad public policy. As Superintendent, I am prepared to consider the areas under OSFI’s purview that could be evaluated taking into consideration the cost-effectiveness of such evaluations.” Since the evaluation affects more than one entity, the government could make the Treasury Board Secretariat responsible for co-ordinating it. The Committee therefore recommends:

That the government immediately carry out a comprehensive evaluation of the system for supervising and regulating federally-regulated financial institutions, ensuring that this program evaluation addresses all aspects of the regulatory system and that the entity co-ordinating the evaluation has the necessary authority, means and resources to do so effectively.

Two aspects in particular caught the Committee’s attention at the meeting and must, in its opinion, form part of the evaluation: (1) clarification of each entity’s responsibilities in order to achieve the objectives; and (2) OSFI’s ability to meet certain major challenges.

Responsibilities of the entities in achieving the objectives

The Committee is of the opinion that, in order to ascertain whether the objectives have been achieved, the entities responsible for achieving them must first be identified. At the meeting, the Committee had the impression that these responsibilities were not always very clear. As the AG noted at the meeting, it has not always been clear which entity is responsible for achieving public policy objectives such as maintaining the stability and competitiveness of the financial system, even after Bill C-100 addressing some of these issues was tabled. The Committee therefore recommends:

That the government define the responsibilities of each entity in achieving the public policy objectives, in order to determine which entities are to be accountable when appropriate. These responsibilities are to be set out clearly in public documents such as the annual reports, or Part III of the *Estimates*, of the entities concerned.

OSFI and CDIC have overlapping responsibilities in supervising deposit-taking and troubled financial institutions. Both entities can intervene in certain situations. The Committee sought to ascertain which entity has the main responsibility when an institution becomes troubled. According to OSFI Superintendent John Palmer, OSFI has the main responsibility as long as there is hope that the institution can be saved. When the institution’s solvency is threatened, CDIC must use the powers given to it by law; CDIC intervention becomes more pronounced as the institution’s financial viability deteriorates. John Palmer also noted that the “Guide To Intervention for Federal Financial Institutions”, outlined in the White Paper entitled *Enhancing the Safety and Soundness of the Canadian Financial System*, would help define OSFI’s and CDIC’s responsibilities at the various stages of an institution’s decline. However, the Committee has not been convinced that these responsibilities, particularly the issue of which entity is to be accountable when things go wrong, are now better defined. The Committee therefore recommends:

That the government more clearly define which entity has the main responsibility for intervening at each of the four steps described in the “Guide To Intervention for Federal Financial Institutions”.

The Committee also sought to ascertain how overlap between OSFI and CDIC responsibilities could be beneficial, something that is not usually the case. The Committee acknowledges that it sometimes may be difficult to avoid certain types of overlap, given the nature of the two entities. However, the Committee does not want those facts to be an excuse for minimizing efforts to reduce overlap. At the meeting, OSFI Superintendent John Palmer admitted that there might indeed be duplication and overlap in cases where both entities supervise financial institutions that are not having any particular problems. The Committee therefore recommends:

That OSFI and CDIC take all possible measures in order to identify and eliminate overlap, particularly in activities involving the supervision of sound financial institutions, and that they first address all the cases identified by the AG in his report.

OSFI’s ability to meet certain major challenges

The Committee is of the opinion that, when the economic climate deteriorates, the presence of an entity like OSFI becomes absolutely crucial. It also believes that OSFI’s activity is indeed to anticipate serious recessions in order to determine their consequences for financial institutions. The Committee considers that in such an eventuality OSFI must be prepared to react quickly. The Committee therefore recommends:

That OSFI draw up a plan of measures to be taken with regard to financial institutions in the event of a profound, serious economic crisis.

In reading the AG’s report, the Committee noted that OSFI may not have all the tools it needs in order to meet the challenges facing it. For example, the emergence of new trends in the financial services industry — such as Canadian banks’ increasing exposure to derivatives — can be observed. Certain specialized operations could have considerable risks for financial institutions’ security and soundness. The Committee believes that OSFI should assess specialized risk areas in greater depth.

The Committee recognizes that the OSFI Superintendent has made efforts in recent months to strengthen that organization. For example, OSFI has made it a priority to draw up guidelines to help examiners make fair decisions, and progress has been made toward that end. The publication of the “Guide To Intervention for Federal Financial Institutions” is also a step in the right direction. The Committee intends to closely follow up on OSFI’s progress. It therefore recommends:

That OSFI provide, by December 31, 1995, a detailed action plan (including target dates) of the measures it intends to take over the next 12 months in order to respond to the recommendations and observations contained in the AG’s report and the concerns expressed by the Committee at the meeting and in this Report.

Pursuant to Standing Order 109, the Committee requests that the government table a comprehensive response to this Report.

A copy of the relevant *Minutes of Proceedings (Issue no. 36 which includes this Report)* is tabled.

Respectfully submitted,

Richard Bélisle

Chair

REPORTS TO THE HOUSE

Thursday, December 7, 1995

The Standing Committee on Public Accounts has the honour to present its

EIGHTEENTH REPORT

Pursuant to Standing Order 108(3)(d), your Committee has considered Chapter 6 of the May 1995 Report of the Auditor General of Canada (*Federal Transportation Subsidies — The Atlantic Region Freight Assistance Program*).

I. INTRODUCTION AND BACKGROUND

In his first interim report, tabled on 11 May 1995, the Auditor General stated his concerns about the wind-up phase of a transportation subsidy program, the Atlantic Region Freight Assistance Program (ARFA). Subsequently, on 6 June, the Committee held a meeting with officials from the Office of the Auditor General (OAG), the National Transportation Agency (NTA), the entity that administers ARFA, and Transport Canada, the department with policy responsibility for the program.

The information contained in the Auditor General's report and the testimony given during the meeting convinced the Committee that concerns about the final phase of the Program were justified. As the Committee learned, the segment of the market occupied by affiliated shippers and carriers was vulnerable to potential inflation of rates when claims for subsidy were submitted. In order to safeguard the interests of Canadian taxpayers, the Committee issued an interim report in which it recommended steps to reduce this risk. It also asked the Chairman of the NTA to confirm that his agency had the authority to assess the rates cited in subsidy claims for their reasonableness and to reject claims based on unreasonable rates. Such an assertion would have confirmed that the Agency now interprets its powers in conformity with the views held by the Minister of Transport. The Chairman was also asked to describe how his agency intended to act on that authority.

Mr. Gilles Rivard, Chairman of the NTA, responded to the Committee's request in a letter dated 5 July 1995. However, instead of confirming that he and his Agency agreed with Transport Canada that the NTA has the authority to assess and reject claims based on the reasonableness of rates, Mr. Rivard maintained the NTA's previous position

that it does not have the authority to either scrutinize freight rates or deny subsidy on the basis of the freight rates charged by carriers for the movements contained in their subsidy claims.

Having stated this, the Chairman indicated that the Agency had "put in place a new Rate and Activity and Review Process for identifying subsidy claims that may contain questionable freight rates." If this new process identified questionable rates, claimants would be asked to explain those rates. The Agency would then make a decision whether or not to pay the claim. "This may mean," the Chairman wrote, "that where an individual carrier fails to satisfy the Agency that a freight rate charged is not excessive, the Agency may deny payment of subsidy."

The Chairman's reply demonstrated that he and his Agency were not in agreement with the Department of Transport with regard to the NTA's powers. It was also apparent that notwithstanding this fundamental disagreement, the NTA, in setting up its new audit process, was proceeding on the basis of an authority it claimed not to possess. As a consequence of this, and because it wished to be informed of the progress being made during the termination phase of ARFA, the Committee met with the Chairman and other officials from the NTA and officials from the OAG on 7 November 1995.

II. OBSERVATIONS

At the meeting, the Chairman of the NTA reiterated the substance of his letter of 5 July. He confirmed that his Agency still does not share Transport Canada's interpretation of the NTA's powers to assess or question the level of freight rates charged by carriers for the movements contained in their subsidy claims. However, despite this disagreement, he had instructed his staff to implement a new process that engages his Agency in an activity for which — in its view — authority is lacking. Mr. Rivard did not indicate that any effort was underway to resolve this disagreement with Transport Canada. Instead, he stated that carriers whose subsidy claims had been rejected could challenge the NTA's authority to do so in the courts. "A court decision in this area," he told the Committee, "would provide absolutely definitive direction on the matter." Mr. Rivard also told the Committee that he had recently obtained an opinion from a senior counsel in administrative law at the Department of Justice to the effect that the NTA does not have the power to assess the rates contained claims for subsidy. Mr. Rivard promised to provide the Committee with the final version of this legal opinion once it is completed.

The Chairman of the NTA also informed the Committee of the progress that has been made during the wind-up phase of ARFA. At the time of the meeting, 2,500 claims had been identified for scrutiny under NTA's new Rate and Activity Review Process. Work had been completed on 600 of these claims and no evidence had yet been found of claims based on excessive or unreasonable rates. Mr. Doug Rimmer, Director General of the NTA's Marine, Trucking and Regional Offices, claimed that lack of such evidence was due perhaps to a deterrence effect — the very existence of the new process was discouraging carriers from submitting claims based on inflated rates. The Committee believes, however, that an additional explanation is possible.

The NTA's Rate and Activity Review Process begins by identifying those carriers most likely to submit claims based on questionable rates. Subsidy claims submitted by these "high risk" carriers since the January 1995 announcement of ARFA's termination are then reviewed. The rates submitted in these claims are compared to those contained in claims submitted by these same carriers prior to the termination announcement. If rate increases are detected, the claimants are asked to justify them. If the explanations given do not satisfy the NTA, the claim is rejected.

Such a process, however, fails to take into account the possibility that the rates submitted by high-risk carriers were inflated prior to January 1995, a possibility that clearly emerges from the Auditor General's report. This being the case, the Agency has established a review process that may simply be comparing yesterday's inflated rates with today's. Thus, while the Rate and Activity Review Process can measure increases in rates, it cannot, by itself determine whether those rates are reasonable. That this process has not uncovered any evidence of claims based on excessive or unreasonable rates should therefore come as no surprise.

Agency witnesses argued that their Rate and Activity Review Process is in accordance with the Auditor General's recommendation that the Agency "compare all [high-risk] claims ... for movements from January 1995 to the end of the program with the claimants' previous claims to assess their reasonableness." This is undeniably so. However, it also reflects a narrow and incomplete reading of the Auditor General's report. That report revealed the strong likelihood that non-arm's length carriers were submitting claims based on rates higher than those charged by their unaffiliated counterparts in order to receive an inflated subsidy. In light of this a more appropriate test of reasonableness ought to include a comparison of the rates charged by these high-risk carriers with those charged by lower-risk, more competitive elements in the trucking business. It is only in this way that evidence of questionable rates can be truly found and the treasury be protected against excessive subsidy payments. Accordingly, the Committee recommends that

The NTA take immediate steps to amend its Rate and Activity Review Process in order to compare the level of freight rates charged by non-arms' length carriers for movements contained in their subsidy claims with rates charged by arm's length carriers and report the results, including the dollar amounts and number of irregularities, of the 2,500 audited claims, to the Committee.

In the meantime, the Committee notes that during the meeting Mr. Rivard demonstrated an openness to making the rate review more rigorous. This included a commitment on his part to go over subsidy payments made since January 1995 to verify whether or not these claims were based on rates that had declined since the termination announcement.

Finally, the Chairman of the NTA was asked whether or not his Agency intended to collect subsidy overpayments on a retroactive basis. Mr. Rivard replied that he would have to check with his senior staff. If he found that his Agency has the power to do this, he would do it. If he found that this authority was lacking, he would do what he could to obtain it from Transport Canada and report the results to the Committee. The Committee looks forward to receiving a timely answer to this question.

III. CONCLUSION

In closing, the Committee wishes to express its profound disappointment that timely action was not taken by those responsible to solve the problems associated with ARFA. As early as 1985, it was known that an important loophole existed in one of the Program's elements. The extent of the NTA's efforts to solve this problem amounted to two letters that were sent to the Department of Transport. There is no evidence that any corrective action was taken in response. The NTA did not pursue the matter further. The loophole remained in place.

A second major event took place that called for swift action on the part of those responsible for ARFA. In the late 1980s, the rates charged by the trucking industry in the region where ARFA was operative were deregulated. Those in charge of the Program's administrative and policy elements ought to have known the impact this change would have on a subsidy regime based on a regulated environment. The Program should have been amended to reflect this change. It was not.

In 1987, another signal was sent to those responsible that there were serious problems with the program. In that year, the Office of the Auditor General released a report listing a number of concerns about ARFA's administration. The report called for an evaluation of the Program and a strengthening of its administrative controls. An evaluation was finally conducted six years later and produced a study that led finally to ARFA's cancellation in July 1995.

Lastly, in 1995, after it was announced that ARFA was being terminated, the Auditor General released a report that has been the basis of this Committee's examination. That report provided clear evidence that certain aspects of the Program were vulnerable to risk and recommended ways of minimizing that risk during ARFA's last phase. Steps have been taken in accordance with this advice, although, as the Committee has noted, those steps are not as rigorous as they could be.

The time for action, however, was not in 1995 during the final months of the Program. As the preceding summary indicates, there was an awareness that something was wrong as early as 1985 — ten years ago. That was when corrective measures should have been taken.

There is more to being a good officeholder than simply following the rules. Those who hold public office are also obliged to show regard for the interests of citizens and to protect those interests to the fullest possible extent. As the Auditor General has pointed out, public service is a public trust. The manner in which ARFA has been mishandled is a glaring example of public trust poorly served. The Committee fully expects that public servants will be proactive in discharging the higher duties which are imposed upon them by the positions they occupy. In so doing, AFRA should serve as an example of what may go wrong when those duties are not fulfilled.

Pursuant to Standing Order 109, the Committee requests the government to table a comprehensive response to this Report.

A copy of the relevant *Minutes of Proceedings (Issue No. 36 which includes this Report)* is tabled.

Respectfully submitted,

Richard Bélisle

Chair

REPORTS TO THE HOUSE

Tuesday, May 28, 1996

The Standing Committee on Public Accounts has the honour to present its

FIRST REPORT

Pursuant to Standing Order 108(3)(d), your Committee has studied Chapter 12 of the Auditor General's October 1995 Report (*Systems under Development: Managing the Risks*). The Committee held a meeting on this subject with representatives from the Treasury Board Secretariat and the Office of the Auditor General on November 28, 1995.

Introduction

When the Auditor General's Report was tabled last October, chapter 12 elicited many comments from all sides. On the one hand, everyone recognizes the importance of investing in information technologies in order to reduce operating costs or improve services provided to taxpayers. On the other hand, hundreds of millions of dollars are presently invested in systems that are under development, and the Auditor General stated in his report that these investments were at risk.

Because of the large amounts at stake, the Auditor General decided to publish his observations in October rather than in his annual report. He hoped in doing so that there would still be time to influence the three projects under development that were reviewed in chapter 12, as well as the twenty or so other projects that have been initiated across the federal government. The Public Accounts Committee held the same view. The Committee wanted to know, among other things, whether the government had embarked on a review of projects currently under way in order to conduct a risk assessment and make the necessary changes to respond to the Auditor General's observations. The Committee also wished to look into the ways in which new projects were managed. Given this context, the Committee decided to invite the Treasury Board Secretariat, rather than a particular department, to the meeting.

Background

Responsibility for systems under development is shared among a number of organizations. Treasury Board approves the projects and the funding required to implement them, on the basis of recommendations from the Treasury Board Secretariat that the Secretariat draws up following an analysis of the business case developed by the department involved. As a central agency, the Treasury Board Secretariat is responsible for the project management framework, and monitors progress against established directions and goals. The departments must manage the development and implementation of the system and perform ongoing maintenance and operation of the system after implementation.

The Treasury Board Secretariat has identified 25 large systems development projects, with a combined budget of more than \$2.1 billion. The Auditor General's audit examined four of these major systems under development. Its conclusions are alarming. The Auditor General found that only one of the four systems reviewed — Transport Canada's Integrated Departmental Financial and Material Management System (IDFS) — is currently being managed in a way that deals effectively with the risks associated with the project. Of the remaining three, the Public Service Compensation System (PSCS) has been terminated by Public Works and Government Services Canada; the Common Departmental Financial System (CDFS), being developed by Public Works and Government Services Canada, has only a small number of committed users; and the Income Security Program Redesign (ISPR) requires continued corrective action by management of Human Resources Development Canada to reduce project risks.

The Public Accounts Committee looked at the Income Security Program Redesign previously when it studied chapter 18 of the Auditor General's 1993 Report (*Programs for Seniors*); it recommended at that time that a progress report on this initiative be submitted to the Committee every year until completion.

Observations and Recommendations

At the start of the meeting, Mr. W.E.R. Little, Deputy Secretary and Deputy Comptroller General, acknowledged the government's poor showing with regard to large systems development projects, although he also stressed that there had been some success stories. He also pointed out that the issue was already under review when the Auditor General tabled his report. The Secretariat has launched a review, in cooperation with the departments, of the 25 projects currently under development. Mr. Little stated that he was in a position to provide some guarantees that the work currently being done would enable the TBS to take measures in the case of the 25 projects, and to develop a framework for new projects. He described some interesting observations that had been made during the review. First, the Treasury Board Secretariat is not convinced that senior management provides the necessary support in all cases to overcome obstacles as they arise in a project. Second, the Treasury Board Secretariat has realized that not all projects are rigorously managed and is concerned about the way in which changes are handled over the course of a project. Third, the Treasury Board Secretariat has concerns about accountability, authority and responsibility and is taking steps to ensure that reports are submitted on systems under development.

Mr. Little gave the Committee a copy of an action plan that makes suggestions for improvements to the existing management framework in order to find solutions to the problems identified. The plan describes tasks to be performed from now until March 1997. Two components of the management framework — governance and review — are of particular importance. With regard to governance, Treasury Board wants to set up a clearer accountability framework. Project funding would be approved in phases, not as a block: the next funding phase would not be approved unless the standards and objectives set for the earlier phase have been achieved. In terms of review, Treasury Board would establish effective mechanisms for monitoring the status of projects and assessing their performance. The Board would also perform complete sanity checks, no longer having to depend solely on the person in charge of the project, but by conducting independent reviews, audits and peer reviews. Treasury Board also intends to conduct more assessments of specific projects, by insisting that the departments provide the results of their own assessments in a format that will allow Treasury Board to gauge the results and to be sure that departments are following the appropriate procedures to bring their projects on line.

The Committee notes that the Treasury Board Secretariat has responded positively to the Auditor General's observations as set out in chapter 12 and that it intends to take specific measures to resolve these issues. However, as the Auditor General pointed out during the meeting, the Treasury Board Secretariat will need a great deal of support and cooperation to make sure its approach will be successful. The Treasury Board Secretariat can set up the best management framework, but it will be useless if it is not applied. Only time will tell whether the new management framework will make it possible to maximize the return on investments in information technology.

During the meeting, the members of the Committee discussed their concerns about the management of systems under development, and other points for consideration in the new approach put forward by the Treasury Board Secretariat. They stressed the importance of sponsorship, ownership and accountability to the success of the project. Senior management must be truly committed to a project when they are spending taxpayers' dollars on its development. As Mr. David Roth, from the Office of the Auditor General, said so clearly at the meeting on November 28, 1995: "The project sponsor ... is the individual who understands the value of a project to the organization, to the government as a whole, who relates the importance of that to the business objectives, and who continually supports and pushes the project. At the end of the day, that person is looked upon as the one who drove the project to a successful completion, or who did not succeed."

The second point that the Committee considers of importance is accountability. The Committee feels that the Treasury Board Secretariat should find ways of motivating people at all levels so that they are completely committed to their project and understand the importance of carrying it through to completion. At the same time, the

Treasury Board Secretariat must tell them clearly that they are accountable. However, even with the best of intentions, it may happen that projects do not develop as they are expected to. According to a study carried out by The Standish Group, which included both private and public sector organizations (some of the results were reported in chapter 12), “a staggering 31.1 per cent of projects will be cancelled before they ever get completed.” It is essential that managers have the tools to identify projects in difficulty and to terminate them when they prove to be beyond repair. The Committee is concerned about the fact that the Office of the Auditor General pointed out that the Public Service Compensation System was in real danger before the department decided to terminate the project. The Committee wonders if this decision would have been made, and especially when it would have been made, if the Auditor General’s observations had not been made public. The Committee is of the view that accountability mechanisms must be finely tuned, or else it will be even easier to feel no responsibility for the failure of a project or to camouflage one’s inability to complete a project successfully. It seems that such mechanisms for rendering accounts are to be incorporated in the new administrative framework. However, the Committee is not convinced that there is adequate control, on the part of the Treasury Board Secretariat, of projects that are under way. Despite Mr. Little’s statement that he had undertaken, in collaboration with the departments, an examination of the 25 projects, allowing for certain measures to be taken, the Committee is still not totally reassured on this issue. In fact, Mr. Little also indicated to the Committee that he would like to have the means at his disposal to monitor the development of those projects more closely. He has, moreover, asked his group to find a way to gather information and to monitor the development of certain projects in particular. For Mr. Little, monitoring the establishment of projects is a question of time and available means and he indicated that his staff was limited in number. Given these facts, the Committee believes that allocation of additional resources to Mr. Little’s group would be a good investment, since it could limit excess spending and allow for the more rapid identification of projects in danger. As a result, the Committee recommends:

That the government consider allocating more staff to the group responsible for monitoring projects in the area of information technology, given the savings that could result from tighter control of costs and deadlines for each project.

Third, the Committee supports the government’s intention to implement systems in “smaller, more chewable chunks” that have the advantage of providing obvious results and benefits more quickly. However, the government will have to be alert as it is important not to lose sight of the final goal of implementing projects in small chunks. In addition, as the Auditor General remarked during the meeting, in making the move to smaller, more chewable chunks, “it is even more important to have a clear idea of where you are going over time and to have a plan that is rigorous enough to ensure that these small projects fit within a longer term project or a longer term strategy.”

Furthermore, the Committee understands that it is the responsibility of departments to manage the development and implementation of systems under development and that the Treasury Board Secretariat must rely on them to obtain the desired information. However, as a central agency, the Treasury Board Secretariat must have a global vision of the government’s “informatics portfolio”. It is important that those who are to make the decision whether to approve a project have access to comprehensive data on anticipated and real costs, the risks associated with the project and progress reports. The Treasury Board Secretariat must ensure that the departments are gathering this information and sending it to the TBS in a timely fashion.

At the meeting, the Committee asked the Treasury Board Secretariat for a report stating whether the target dates for completion of each of the 25 projects were likely to be met. The Committee also wished to obtain a list of the names of those heading the projects. Furthermore, the Committee wanted to be kept informed about whether the projects were successes or failures as they were completed. Mr. Little agreed to provide this information. Considering the magnitude of the investment in information technologies, the Committee is of the view that this type of information may be useful for parliamentarians and should be provided on a regular basis. It does not think this will be an undue burden as the Treasury Board Secretariat has already asked the departments to develop a mechanism for assessing the risks associated with each of the 25 existing projects, and in terms of new projects, the Treasury Board Secretariat must have this information on hand in order to free up the funds the department needs to move on to the next stage. Consequently, the Committee recommends:

That the Treasury Board Secretariat produce an annual report on the status of departments' investments in systems under development, comprising: (1) a fact sheet about each project (purpose, initial cost, budgets and objectives set for each stage, person responsible); (2) historical data (investments in projects, success rate); (3) project management information (is the project in difficulty, are there cost overruns, will timelines be met); and (4) action taken by the Treasury Board Secretariat (funding approval denied, warning, audit); and

That, prior to the funding (of any project), Treasury Board Secretariat ensure complete sponsorship, ownership, buy-in of ideas, accountability and, if possible, that the project be divided into chewable chunks.

Conclusion

The Committee is well aware that there is no miracle solution for the challenges involved in IT project management. The Committee feels that the Treasury Board Secretariat, having gone through a process of soul-searching, is now on the right track with the establishment of a new management framework. The Committee recognizes that the Treasury Board Secretariat alone will not be able to change the methods currently used to implement and manage systems development projects. The departments have a crucial role to play in this. In the prevailing context of budget cutbacks, the government can simply not afford to put millions of dollars into low-yield investments. From this point of view, it is important that the Treasury Board Secretariat show greater leadership so that all departments will be in a position to respond to the opportunities and challenges of implementing information technologies across the federal government.

Pursuant to Standing Order 109, the Committee requests the government to table a comprehensive response to this Report.

A copy of the relevant *Minutes of Proceedings (Issue No. 36 of the First Session and Issue No. 1 of the Second Session of the 35th Parliament which includes this Report)* is tabled.

Respectfully submitted,

Michel Guimond

Chair

REPORTS TO THE HOUSE

Thursday, June 20, 1996

The Standing Committee on Public Accounts has the honour to present its

SECOND REPORT

In accordance with its Order of Reference of Thursday, March 7, 1996, your Committee has considered Vote 30 under FINANCE in the Main Estimates for the fiscal year ending March 31, 1997 and reports the same.

A copy of the relevant *Minutes of Proceedings (Issue No. 1 which includes this Report)* is tabled.

Respectfully submitted,

Michel Guimond

Chair

APPENDIX D

**REPORT ON THE AUDIT OF THE
PRESIDENT OF THE TREASURY BOARD'S REPORT TO PARLIAMENT:**

**TABLINGS IN PARLIAMENT FOR PARENT CROWN CORPORATIONS:
ANNUAL REPORTS AND
SUMMARIES OF CORPORATE PLANS AND BUDGETS**

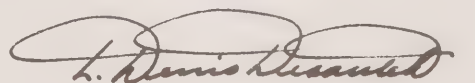
Introduction. The *Financial Administration Act* requires the President of the Treasury Board to lay before each House of Parliament a report concerning the timing of tabling, by appropriate ministers, of annual reports and summaries of corporate plans and budgets of Crown corporations subject to the reporting provisions of Part X of the Act.

The report on these tablings allows Parliament to hold the appropriate ministers (and, ultimately, the Crown corporations) accountable for providing, within the relevant statutory deadlines, the information required under the *Financial Administration Act*. Accordingly, the report is required to indicate the time at, before, or within which the annual reports and the summaries of corporate plans, capital budgets and operating budgets (and amendments to them) were required to be tabled before each House during the reporting period; and the time they were actually tabled. The report on tablings is included in the President of the Treasury Board's annual report to Parliament, *Crown Corporations and Other Corporate Interests of Canada*.

Scope. In my annual Report to the House of Commons, I am required by subsection 152(2) of the *Financial Administration Act* to attest to the accuracy of the information contained in the President of the Treasury Board's report on tablings. Accordingly, I have examined the report for the year ended 31 July 1996, to be tabled not later than 31 December 1996*.

My examination included a review of the systems and procedures used by Treasury Board to monitor the tabling of the summaries and annual reports in each House of Parliament, a verification of the information contained in the report, and such other tests and procedures as I considered necessary in the circumstances.

Opinion. In my opinion, the information contained in the report about the timing of tabling, by the appropriate ministers, of Crown corporations' annual reports and summaries (and amendments to them) of corporate plans, capital budgets and operating budgets is accurate in all significant respects.



L. Denis Desautels, FCA
Auditor General of Canada

OTTAWA, 10 October 1996

* Not tabled at time of going to press

APPENDIX E

The Costs of Crown Corporation Audits Conducted by the Office of the Auditor General of Canada

Section 147 of the *Financial Administration Act* requires that the Office disclose the costs of preparing audit reports on all Crown corporations other than those exempted under section 85 of the Act (see Exhibit 1). An audit report includes an opinion on a corporation's financial statements and on its compliance with specified authorities. It may also include reporting on any other matter deemed significant.

The Office is also required by section 68 of the *Broadcasting Act* to report the cost of any audit report on the Canadian Broadcasting Corporation. For the fiscal year ended 31 March 1996, the full cost of the annual audit report was \$481,933 and the cost for the special examination reported in 1995-96 was \$1,352,520.

Section 138 of the *Financial Administration Act* requires that, at least once every five years, each parent Crown corporation named in Schedule III of the Act undergo a special examination. This is distinct from the requirement for the annual audit of financial statements.

The objective of a special examination is to determine whether a corporation's financial and management control and information systems and its management practices provide reasonable assurance that:

- assets have been safeguarded and controlled;
- financial, human and physical resources have been managed economically and efficiently; and
- operations have been carried out effectively.

In 1995-96 the Office completed the special examination of 6 Crown corporations. The costs to the Office were:

Canadian Dairy Commission	\$ 382,740
Canadian Museum of Civilization	999,230
Canadian Museum of Nature	813,120
National Gallery of Canada	740,310
National Museum of Science and Technology	315,270
Queens Quay West Land Corporation	5,860

Exhibit 1

**Costs of Preparing Annual Audit
Reports for Fiscal Years Ending
on or before 31 March 1996**

Crown Corporation	Fiscal Year Ended	Cost Incurred
Atlantic Pilotage Authority	31.12.95	\$ 43,814
Atomic Energy of Canada Limited	31.03.96	444,813
Canada Deposit Insurance Corporation	31.03.96	221,922
Canada Development Investment Corporation (Joint Auditor)	31.12.95	14,564
Canada Lands Company Limited (Joint Auditor)	31.03.96	89,087
Canada Lands Company (Vieux-Port de Québec) Inc.	31.03.96	6,567
Canada Mortgage and Housing Corporation (Joint Auditor)	31.12.95	290,719
Canada Museums Construction Corporation Inc.	31.03.96	9,246
Canadian Commercial Corporation	31.03.96	115,600
Canadian Dairy Commission	31.07.95	135,505
Canadian Museum of Civilization	31.03.96	75,506
Canadian Museum of Nature	31.03.96	105,091
Cape Breton Development Corporation	31.03.96	327,768
Defence Construction (1951) Limited	31.03.96	35,289
Enterprise Cape Breton Corporation	31.03.96	100,570
Export Development Corporation	31.12.95	351,534
Farm Credit Corporation	31.03.96	406,566
Federal Business Development Bank (Joint Auditor)	31.03.96	234,375
Freshwater Fish Marketing Corporation	30.04.95	58,340
Great Lakes Pilotage Authority, Ltd.	31.12.95	73,547
Laurentian Pilotage Authority	31.12.95	91,761
Marine Atlantic Inc. (Joint Auditor)	31.12.95	120,177
National Capital Commission	31.03.96	196,862
National Gallery of Canada	31.03.96	73,691
National Museum of Science and Technology	31.03.96	61,888
Old Port of Montreal Corporation Inc.	31.03.96	78,505
Pacific Pilotage Authority	31.12.95	53,251
Petro-Canada Limited	31.12.95	26,462
Queens Quay West Land Corporation (Joint Auditor)	31.03.96	17,764
Royal Canadian Mint	31.12.95	242,333
The St. Lawrence Seaway Authority	31.03.96	205,490
Seaway International Bridge Corporation Ltd.	31.12.95	60,328
The Jacques Cartier and Champlain Bridges Incorporated	31.03.96	92,307
Standards Council of Canada	31.03.96	34,948
VIA Rail Canada Inc. (Joint Auditor)	31.12.95	230,013

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